A Report on Our Business 2002

NEXFOR

Nexfor

NEXFOR at a glance

	Overview	Highlights
North American Building Materials 	Nexfor manufactures and markets wood-based panel products and lumber for construction and industrial use. Nexfor's products include oriented strand board (OSB), medium density fibreboard (MDF), hardwood plywood, softwood lumber and I-joists. Nexfor's North American Building Materials business manages approximately two million hectares of forest, operates 18 mills and employs approximately 3,000 people.	• Became largest OSB producer in US South with the acquisition of two mills in Texas, one in Georgia • Immediately integrated new OSB mills – on track to achieve $16 million in operational synergies by end of 2003 • Generated $14 million in margin improvements • Earnings before interest, taxes, depreciation and amortization (EBITDA) up 48% to $104 million • Set annual production records at five operations
European Panels 	Nexfor is the largest manufacturer of panels in the UK, producing a range of OSB, MDF and particle-board products for construction, furniture, interior design and do-it-yourself industries. Nexfor's European Panels business operates three mills and employs approximately 900 people.	• Achieved $18 million improvement in financial performance, largely through margin improvements • Generated $21 million in EBITDA • Increased sales of kitchen cabinetry 30% • Achieved 33% improvement in safety performance • Improved performance of value-added business
Paper and Pulp 	Nexfor is a niche producer of specialty papers, operating six paper and pulp mills in New Brunswick, Quebec, Maine, New Hampshire and Wisconsin. Total annual production capacity is 1.25 million tonnes. Highly integrated, Nexfor's Paper and Pulp operations employ approximately 3,200 people, manage more than one million hectares of forest and operate a tree nursery.	• Expanded specialty paper capacity with addition of 145,000 tonnes of production at acquired Gorham, New Hampshire, mill • Improved integration of paper operations by acquiring 240,000 tonne pulp mill in Berlin, New Hampshire • Generated $24 million in EBITDA • Increased specialty paper ratios at the Park Falls, Wisconsin, mill to 62% in 2002 from 47% in 200 • Significantly improved financial performance of Midwest operations • Achieved 99.9% environmental compliance

North America

United Kingdom

Building Materials

Paper and Pulp

Sales and Shipments

NORTH AMERICAN BUILDING MATERIALS

	2002 Net Sales ($ millions)	2002 Shipments (volumes)	*2001* Net Sales ($ millions)	*2001* Shipments (volumes)
OSB *(MMsf-3/8")*	$ 353	16,100	$ 195	9,015
Lumber *(MMfbm)*	168	681	159	665
Plywood *(MMsf-3/8")*	44	472	43	479
MDF *(MMsf-3/4")*	25	930	25	951
I-joist *(MM lineal ft.)*	23	30	20	27
Other (1)	41	–	33	–
Total	$ 654		$ 475	

(1) Other sales are primarily logs.

Market Distribution

84% – United States
16% – Canada

EUROPEAN PANELS

	2002 Net Sales ($ millions)	2002 Shipments (MMsf-3/8")	*2001* Net Sales ($ millions)	*2001* Shipments (MMsf-3/8")
OSB	$ 36	1,757	$ 34	1,729
MDF	61	2,302	51	2,103
Particleboard	63	3,317	66	3,566
Other (1)	67	–	57	–
Total	$ 227	7,376	$ 208	7,398

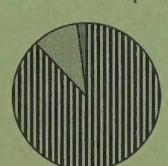
(1) Other sales include laminated products, furniture components and ready-to-assemble furniture units.

100% – Europe

PAPER AND PULP

	2002 Net Sales ($ millions)	2002 Shipments (000 tonnes)	*2001* Net Sales ($ millions)	*2001* Shipments (000 tonnes)
Woodfree paper	$ 401	369	$ 390	362
Groundwood paper	130	178	156	186
Paperboard	26	52	27	51
Towel	12	17	–	–
Pulp	85	230	85	229
Intra-segment and other	(54)	–	(23)	–
Total	$600	846	$ 635	828

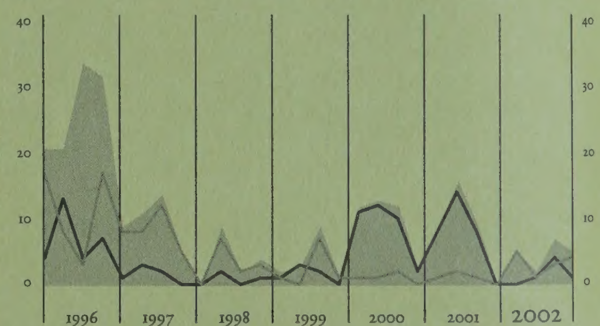
88% – United States
10% – Canada
2% – Europe



Environment, Health and Safety

ENVIRONMENTAL COMPLIANCE

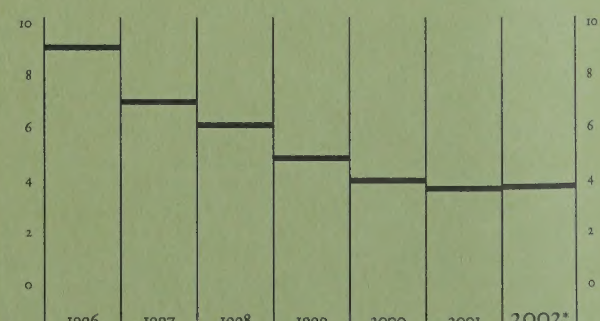
Overall Exceedances
Air Emission Exceedances
Effluent Exceedances



Of more than 16,000 compliance measurements at Nexfor's paper and pulp mills, 14 exceeded regulatory limits.

SAFETY PERFORMANCE

Number of recordable health and safety incidents per 200,000 hours worked (Occupational Safety and Health Administration (OSHA) recordable rate)



* Effective January 2002, OSHA implemented revised reporting standards. Nexfor's 2002 OSHA recordable rate incorporates the new reporting criteria, which distorts the data for year-over-year comparisons.

CORPORATE profile

Nexfor Inc., a forest products company headquartered in Toronto, Ontario, employs 7,100 people at operations in Canada, the United States and the UK. The Company comprises 27 operating locations in three business segments: North American Building Materials, European Panels and Paper and Pulp.

FINANCIAL highlights

Years ended December 31 *($ millions, except per share information)*	2002	2001	2000
OPERATIONS			
Net sales	$ 1,481	$ 1,318	$ 1,362
Operating earnings	28	22	114
Earnings	13	12	94
Cash provided by operations	146	106	134
Capital expenditures	44	100	173
PER COMMON SHARE			
Diluted earnings	$ 0.08	$ 0.07	$ 0.61
Dividends	0.26	0.26	0.26
Free cash flow	0.72	0.04	(0.27)
Book value	5.30	5.50	5.65
Stock price (TSX) *(CAD $)*			
High	$ 9.70	$ 8.45	$ 9.25
Low	7.13	6.30	5.85
Close	8.25	7.50	7.10
RETURN ON CAPITAL EMPLOYED	10%	8%	15%

All financial results are reported in US dollars, unless otherwise noted.

TO OUR shareholders

Nexfor made significant strides in improving the earnings potential and value of the Company.

Despite a prolonged period of weak product prices and depressed earnings throughout the entire forest products industry in 2002, Nexfor made significant strides in improving the earnings potential and value of the Company. Our goal is to maximize share value by investing in our core businesses – wood panels and specialty papers.

Over the last three years, we've moved more of our asset base into panels, specifically OSB. OSB is still the single best growth opportunity in the forest products industry. Today, 66 percent of our capital is employed in, and 59 percent of our sales revenues are derived from, the building materials sector. While our focus is on return on capital employed, we are now the world's third-largest OSB producer, and second largest in the United States. More important, we are one of the lowest cost producers in the US, and our mills are located close to rapidly growing markets. We are also the largest panelboard producer in the United Kingdom, with leading market shares in OSB, MDF and particleboard flooring.

No less important to our strategy is specialty paper. We are tightly focused in this business. With 34 percent of our capital employed and 41 percent of sales revenues, specialty papers constitutes a niche business in which we have a proven reputation for excellence, innovation and superior customer service.

Our 2002 results reflected a sluggish economy and weak product prices due to overcapacity in building materials and groundwood papers. Earnings in 2002 were, for the most part, unchanged from 2001. However, sales for the year were 12 percent higher, while earnings before interest, taxes and depreciation of $149 million were $32 million, or 27 percent better than last year. Most significantly, we generated $102 million in free cash flow, which was used to invest in strategic opportunities, reduce debt and pay dividends.

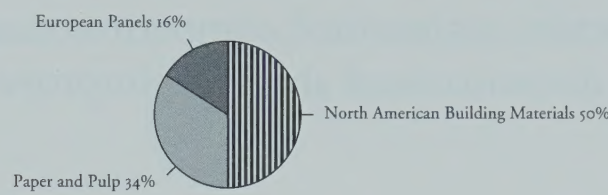
Late in the year, we announced we would begin reporting our financial results in US dollars. It makes good sense to do this. More than 60 percent of our assets are located in the United States, and more than 85 percent of our sales are denominated in US dollars. The impact has been immediate. We've been able to significantly reduce our hedging requirements and reduce foreign currency distortions, thereby improving the clarity of our results.

STRATEGIC GROWTH

In keeping with our strategy to invest in our core businesses, we acquired three OSB mills for $250 million last April. The acquisition is part of continuing industry consolidations that will benefit companies like Nexfor. As a result, Nexfor is now the leading OSB producer in the US South with six modern facilities and a new and expanded customer base in the key growth markets we've been targeting. Our total North American OSB production capacity has increased 45 percent, sales revenues are higher and we're achieving further economies of scale.

Last May, we expanded our specialty papers business and enhanced our earnings potential with the acquisition of a paper and pulp complex in New Hampshire. These integrated operations produce 181,000 tonnes of paper and 240,000 tonnes of pulp. Of the total, 145,000 tonnes of paper grades complement our existing product mix, and provide Nexfor with improved manufacturing flexibility and operating efficiency at all our paper operations. The Berlin, New Hampshire, pulp mill, which is scheduled to start up in 2003, provides Nexfor with full pulp self-sufficiency. The acquisition did not compromise our

2002 NET ASSETS EMPLOYED BY OPERATING SEGMENT



balance sheet as these facilities were acquired for a nominal amount. When the Berlin and Gorham operations in New Hampshire are ramped up to capacity, we expect higher earnings from our specialty paper business.

DEBT REDUCTION

Nexfor has always maintained a conservative balance sheet, with a net debt/total capitalization ratio traditionally between 25 and 40 percent. Acquisitions in 2002 increased our level to 44 percent at year-end. In 2003, high on our priorities will be to return our debt/capitalization ratio to within our target range by maximizing our cash flow from operations and further divesting non-core assets.

OPTIMIZING ASSETS

Disciplined capital allocation has been an important aspect of our operating philosophy. In prior years, the bulk of our capital spending had been directed at greenfield projects and strategic acquisitions. Our continuous improvement culture has also meant that we've been successful at improving the ongoing efficiency of our operations without injecting capital. As a result, we have some of the lowest-cost facilities in the business.

In 2003, we expect to invest approximately $65 million in our operations. About half will be directed to efficiency improvements at our newly acquired mills and the other half directed at optimizing the performance of Nexfor's other operations. You can rest assured that all capital projects will meet minimum return requirements or they will not be undertaken.

BUSINESS IMPROVEMENTS

Across our business, Nexfor maintained competitiveness through a demonstrated ability to improve margins. While not always apparent to the bottom line, margin improvements are crucial to maintaining competitiveness in a commodity-based industry like ours. Since we formally initiated our Margin Improvement Program (MIP) in 1998, we've identified and implemented more than $165 million of initiatives that offset lower selling prices and higher costs for wood and energy. During 2002, we generated $33 million from production volume increases, improved product mix, cost reductions and the application of new ideas that will continue to generate savings in years to come.

In the United Kingdom, MIP led to a significant improvement in financial performance. We're now realizing the benefits of being a low-cost, higher volume producer. We also divested or consolidated unprofitable activities such as furniture grade particleboard and laminating operations, reduced total manpower by 30 percent, and reorganized our management team.

Markets and prices in Europe are still a long way from their highs. However, there are encouraging signs for continued improvement in 2003 as prices are firming. The pound is weakening in relation to the Euro. The UK economy is relatively healthy compared to other European economies. Demand growth for OSB and MDF in Europe continues. Furthermore, we don't expect to see capacity expansions in the near term.

Across our business, Nexfor maintained competitiveness through a demonstrated ability to improve margins.

In North America, our Midwest paper mill at Park Falls, Wisconsin, continued to demonstrate dramatic improvement, significantly reducing costs and improving efficiency in virtually every area of its operation.

Similarly, cost reductions and operating efficiencies were achieved throughout the North American Building Materials operations. Production records were set at several operations and the group is well on track to achieve at least $16 million in cost and efficiency improvements by the end of 2003 stemming from the OSB acquisition in 2002.

SAFETY

Safety is critically important to Nexfor. As is margin improvement, safety is ingrained in our culture to make continuous improvements and to avoid dangerous situations at all costs. Our goal is a 20 percent year-over-year reduction in our Occupational Safety and Health Administration (OSHA) recordable rate. Our six percent improvement fell short of that target, yet we did improve for the eighth consecutive year. Our UK operations recorded the lowest rate of all our business units, thanks largely to the adoption of behavioural awareness programs and heightened management commitment. Likewise, Paper and Pulp operations achieved their best-ever performance. At our North American Building Materials operations, the OSHA recordable rate increased. We've responded with an aggressive "100% Compliance" initiative that we're confident will address unsafe behaviours and improve our performance.

CORPORATE GOVERNANCE

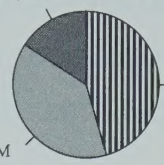
There has been heightened concern in the corporate world over the past year about governance and shareholder disclosure. Revised legislative and regulatory requirements in the US and Canada resulted in a re-examination of practices and policies that ensure shareholders are fairly and sufficiently represented.

I'm pleased to say that Nexfor fares extremely well with respect to investor and regulatory expectations for clarity, transparency and full disclosure. In 1993, we adopted a formal code of business conduct that all our managers are required to review and endorse every year. Our annual report to shareholders has repeatedly won The Canadian Institute of Chartered Accountants (CICA) and journalism awards for the depth and clarity of its content. In 1994, our Board of Directors established a Corporate Governance Committee alongside our existing committees for audit, environment, human resources and pension. This Committee clearly defines what we expect from our management team and board members; how they should be qualified, roles and responsibilities, their independence and the scope of their involvement.

LISTENING TO INVESTORS

Beyond traditional governance, investors and top management must meet regularly to exchange information and evaluate each other's expectations. During 2002, John Tremayne, our Chief Financial Officer, and I met with many institutional analysts and investors, and our presentations are always posted on our web site. Shareholders are invited to write or e-mail us at any time with questions or concerns.

2002 CAPITAL INVESTMENTS – $44 MILLION



I'd like to share with you some of the comments we heard at our investor relations meetings:

- Our business strategy makes sense and is consistent with our competitive strengths.
- Our actions are consistent with our strategy.
- Our ability to pay shareholder dividends throughout the business cycle reflects a disciplined use of capital.
- Our conservative deployment of capital is well regarded.
- Our operations are run by an experienced and respected team.
- Our stock price does not adequately reflect our value.
- Our paper business has underperformed.
- The industry should not add capacity at this time.

CLEAR FINANCIAL PRIORITIES

Our key financial objective is to achieve a pre-tax 17 percent, or after-tax 12 percent return on common equity over the business cycle. Our financial priorities supporting this objective for 2003 are clear:

- Generate 20 percent returns from strategic acquisitions.
- Continue to find innovative ways to generate margin improvements.
- Limit capital expenditures and manage working capital to ensure maximum return on investment.
- Divest non-core assets.
- Maintain financial strength and flexibility.

In meeting these priorities, Nexfor will continue to maintain a strong balance sheet and will grow core businesses.

THE IMPORTANCE OF TALENT

The ability to recruit, train and mentor the right people to quickly step forward and lead will always be a barometer of our success. During 2002, as a result of our acquisitions and continuous improvement processes, we filled more than 130 positions with people who were promoted from within the Nexfor ranks. I want to thank these new appointees, and all Nexfor personnel, for taking on the challenges our company has faced this year and raising the bar on expectations for 2003.

I would also like to thank our Board of Directors for its support and stewardship. It too continues to set higher expectations of itself and of Nexfor's management team.

DOMINIC GAMMIERO
President & Chief Executive Officer

PERFORMANCE report card

Our continuous improvement culture has also meant that we've been successful at improving the ongoing efficiency of our operations without injecting capital. As a result, we have some of the lowest-cost facilities in the business.

2002 TARGET	2002 PERFORMANCE
1. Grow OSB business	• Acquired three OSB mills in the US South. • Increased total North American production capacity by 45% to 3.3 billion square feet (⅜").
2. Grow specialty paper business	• Added 145,000 tonnes of specialty paper capacity to Nexfor product mix through the acquisition of Gorham paper operation in New Hampshire. • Increased overall specialty paper ratio to 69%.
3. Integrate new operations	• On track to achieve $16 million in OSB operating synergies by the end of 2003. • Started up all five paper machines at Gorham mill.
4. Generate $30 million in margin improvements	• Generated $33 million in margin improvements.
5. Achieve $56 million in free cash flow	• Generated $102 million in free cash flow.
6. Maintain disciplined capital allocation	• Held capital investments at $44 million.
7. Improve financial performance at UK operations	• Achieved $18 million improvement in operating earnings, largely due to margin improvements.
8. 100% environmental compliance	• Achieved 99.9% at paper and pulp operations; 98.2% at building materials operations.

2002 TARGET	2002 PERFORMANCE
9. Improve safety performance 20%	• Improved performance 6% through the implementation of behaviour-based safety programs across the Company.
10. Pursue public debt issue	• Completed $250 million issue of 10-year debentures at 7.25%.
11. Convert to US dollar reporting	• Implemented in the fourth quarter.
12. Strengthen relations with institutional investors	• Doubled the number of meetings and presentations over 2001.
13. Improve financial performance at Midwest paper operation	• Earnings before interest, taxes, depreciation and amortization increased $5 million.
14. Introduce new products	• Introduced Pegasus Super Smooth text and cover at the Park Falls, Wisconsin, mill in April. • Began producing Solarboard OSB at newly acquired OSB mill in Jefferson, Texas.
15. Complete forest certification in North America	• On track to complete *Sustainable Forestry Initiative*® (SFI®) program certification of all North American wood procurement and woodland operations by the end of the first quarter in 2003.

2002 FINANCIAL performance

MANAGEMENT'S DISCUSSION *and* ANALYSIS

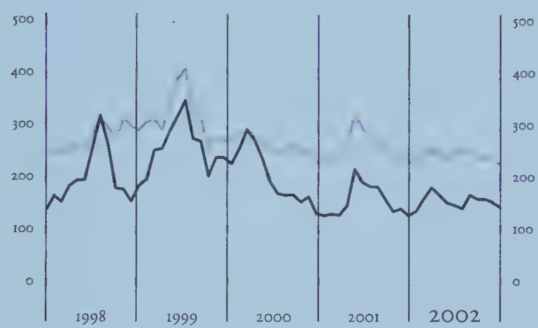
2002 *financial* STATEMENTS

2002 overview

PANELS

Price ($ per Msf)

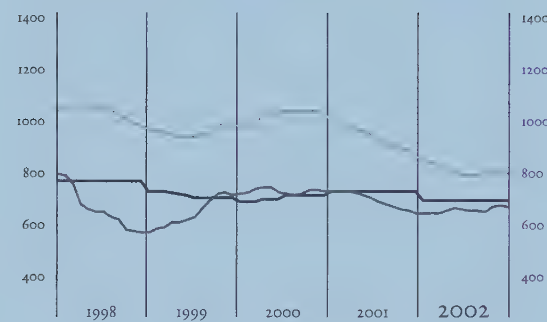
— North Central OSB 7/16"
— Southern Plywood 15/32"



PAPER

Price ($ per ton)

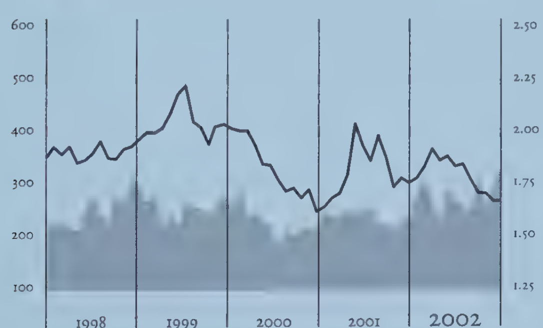
— Coated No. 5
— Uncoated Offset
— White Directory



BOSTON LUMBER

Price ($ per Mfbm) Housing Starts (million units)

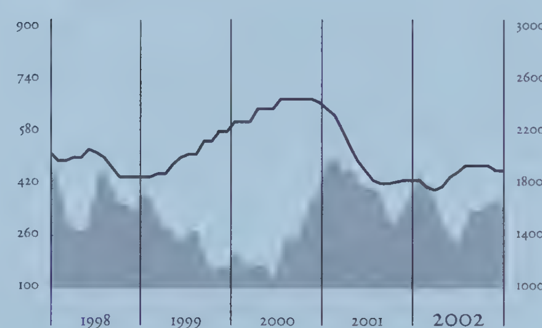
— Price
US Housing Starts S.A.A.R.



HARDWOOD PULP

Price ($ per tonne) Inventories (000 tonnes)

— Price
Norscan Inventories



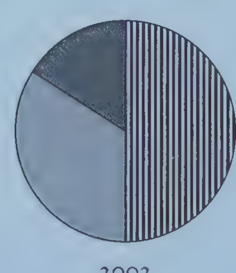
EBITDA

($ millions) (excluding sold operations)

EBITDA – Earnings before interest, taxes, depreciation and amortization

NET ASSETS EMPLOYED

50% – North American Building Materials
34% – Paper and Pulp
16% – European Panels



THE YEAR in review

The Management's Discussion and Analysis (MD&A) provides a review of the significant developments that impacted Nexfor's performance during 2002 relative to 2001. Factors that could impact future operations are also discussed. Such comments will be affected by, and may involve, known and unknown risks and uncertainties that may cause the actual results of the Company to be materially different from those expressed or implied. To enhance shareholders' understanding, certain five-year historical financial and statistical information is presented. Nexfor's significant accounting policies and other financial disclosures are contained in the audited financial statements and accompanying notes, which follow this Management's Discussion and Analysis.

Throughout this discussion "Nexfor" refers to Nexfor Inc. and all of its consolidated subsidiaries and affiliates, and "Company" refers to Nexfor Inc. as a separate corporation. "EBITDA" refers to earnings before interest, taxes, depreciation and amortization. "OSB" refers to oriented strand board, a panelboard produced by gluing strands of wood under heat and pressure, and "MDF" refers to medium density fibreboard, a panelboard produced by chemically bonding wood fibres and fibre bundles of uniform size under heat and pressure.

US DOLLAR reporting

All financial references in the MD&A are stated in US dollars unless otherwise noted. During the fourth quarter of 2002, the US dollar became the functional currency of Nexfor's Canadian subsidiaries. Concurrent with this change, Nexfor adopted the US dollar as its reporting currency.

Under Canadian generally accepted accounting principles (GAAP), the change in reporting currency was effected using the translation of convenience method whereby all historical financial transactions and balances are translated into US dollars using the exchange rate in effect on the date of changing the reporting currency. The exchange rate used was CAD $1.00 = US $0.638.

STRATEGY

Nexfor operates in three business segments: North American Building Materials, European Panels, and Paper and Pulp. It is the world's third-largest OSB producer, the United Kingdom's largest producer of wood-based panels and a market leader in niche specialty paper products.

Nexfor's strategy focuses on the following goals:

- Develop strong market positions in core products.
- Capitalize on growth segments within the forest products industry.
- Increase the specialty/value-added component of sales.
- Remain a low-cost producer in commodity segments.
- Maintain a strong financial position.
- Maintain disciplined capital allocation.

The Company's key financial goal is to achieve a minimum 12% return on common equity (ROE) over the business cycle. In addition, we target a top-quartile performance among peer companies as measured by pre-tax cash return on capital employed (ROCE).

A significant repositioning of the Company has taken place since 1998 following a comprehensive strategic review of all businesses. At year-end 1998, paper and pulp accounted for 65% of Nexfor's net assets employed and building materials comprised 35%. At December 31, 2002, the split was essentially reversed with paper and pulp at 34% and building materials at 66%.

2002 acquisitions

Effective April 1, 2002, Nexfor acquired three OSB mills in the Southern US for cash consideration of $250 million, including $8 million of operating working capital. Two of the mills are located in Texas and one in Georgia. The purchase positioned Nexfor as the second-largest OSB producer in the US and the largest in the US South. The purchase was funded from a $150 million bridge loan, $66 million of cash and the balance from existing credit facilities.

Excellent progress was made integrating the new mills during the year. Savings from synergies are on track to achieve the $16 million target by the end of 2003. Production from the three mills totalled 746 million square feet (3/8-inch basis) in the period April through December. Total annual capacity from the three acquired mills is projected at 1,150 million square feet once capital projects are completed in 2004.

On May 31, 2002, Nexfor acquired a paper mill, a hardwood kraft pulp mill and a landfill facility in Northern New Hampshire for a nominal amount, providing a unique opportunity to grow the specialty paper business. Both mills had been shut since August 2001 following the bankruptcy of the previous owner. The five paper machines at Gorham, New Hampshire, have a capacity of 181,000 tonnes per year. Eighty percent of Gorham's production will be in lightweight opaque, technical specialties, trade book and commercial printing papers, building directly on products already produced at other Nexfor mills. Industrial-quality towel products account for the remaining 20%. All five paper machines were put in service during 2002.

The pulp mill at Berlin, New Hampshire, is expected to start up in 2003 after quality and production improvements are completed. The mill will have an annual capacity of 240,000 tonnes of hardwood kraft pulp. The pulp will be used principally at the nearby Gorham paper mill and Nexfor paper facilities in Maine and Wisconsin.

In December, Nexfor sold the landfill facility in New Hampshire for proceeds of $10 million and signed an agreement to utilize the facility to dispose of its waste. A gain of $3 million was recorded in 2002. The balance of the gain has been deferred and will be amortized over five years, the minimum term of the agreement.

BUSINESS profile

Overview

At December 31, 2002, Nexfor employed approximately 7,100 people at manufacturing facilities in the United States, Canada and the United Kingdom. The geographical breakdown of net fixed assets at year-end 2002 was 60% US, 24% Canada and 16% UK.

Principal operating facilities include:

- Fourteen panelboard mills
- Six sawmills
- One I-joist plant
- Six paper and pulp mills

The annual production capacity of these facilities at year-end 2002 was close to five billion square feet (3/8-inch basis) of panel products including OSB, MDF, particleboard and plywood, 80 million lineal feet of I-joists, 720 million board feet of lumber, and 1.25 million tonnes of paper and pulp.

Nexfor manages, according to internationally recognized standards, close to 3 million hectares of timberland in North America, of which 429,000 hectares are owned. More than 75% of the owned land is in Canada. The non-owned timberland in Canada is managed under long-term licences granted by provincial governments. Nexfor also purchases timber, chips and other wood residues on the open market.

FINANCIAL SUMMARY

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
Net sales	$ 1,481	$ 1,318	$ 1,362	$ 1,503	$ 1,508
Operating earnings	28	22	114	175	98
Depreciation	121	95	92	103	107
Earnings	13	12	94	170	30

2002 was another difficult year for the forest products industry. Results in 2002 were adversely affected by sluggish economic activity, weak prices and overcapacity in the Building Materials segment. Nexfor recorded 2002 earnings of $13 million or $0.08 per common share. In 2001, earnings were $12 million or $0.07 per share.

Despite the challenging environment, we pursued a number of actions that enhanced Nexfor's earnings potential:

- Generated free cash flow of $102 million.
- Acquired three OSB mills in the US South.
- Acquired integrated paper and pulp facilities in Northern New Hampshire.
- Achieved acquisition-related synergies.
- Achieved $33 million in margin improvements.
- Maintained disciplined capital investments at $44 million, 36% of depreciation.
- Reduced working capital requirements by $32 million.
- Improved European Panels operating results by $18 million.
- Ramped up new particleboard line at Cowie, Scotland.
- Continued ramp-ups at new OSB mills in South Carolina and Alabama.
- Established annual production records at a number of operations.
- Improved liquidity by issuing $250 million, 7.25% debentures maturing July 2012.
- Reduced Occupational Safety and Health Administration (OSHA) recordable rate by 6%.
- Achieved environmental compliance at 99.9% at Paper and Pulp operations and 98.2% at Building Materials operations, within regulated air and water emission limits.
- Achieved SFI program certifications.

The Margin Improvement Program (MIP) remains the cornerstone of Nexfor's efforts to "control the controllables." Measured at constant prices and exchange rates, MIP realized a $33 million improvement over 2001, exceeding the target of $30 million. Approximately 65% of 2002 MIP is attributed to mix, 20% to volume and 15% to cost.

The contribution of MIP by segment was:

- European Panels 50%
- North American Building Materials 40%
- Paper and Pulp 10%

Nexfor's ROCE rose to 10% in 2002 from 8% in 2001 as EBITDA growth more than offset a higher capital base. The capital base increased due to the strategic acquisitions. ROCE is defined as EBITDA divided by the sum of property, plant and equipment, operating working capital (accounts receivable plus inventory less accounts payable) and other assets (excluding a convertible debenture investment). ROCE is a key measurement of financial performance, focusing on cash and the efficient use of capital. Over the past five years, Nexfor's ROCE has averaged 14%, a second quartile performance relative to the North American forest products industry. ROE was 1% in 2002, unchanged from 2001.

Cash flow from operations, including changes in non-cash working capital, totalled $146 million in 2002 compared to $106 million in 2001. After capital expenditures, free cash flow generated was $102 million or $0.72 per share compared to $6 million in 2001. On July 2, the Company issued $250 million of 7.25% debentures, using the proceeds to pay down outstanding indebtedness. At the end of 2002, committed bank lines were $293 million, of which $15 million was utilized.

Cash and short-term notes totalled $67 million at December 31, 2002, compared to $116 million at year-end 2001. In addition, other assets at December 31, 2002, included $49 million of convertible debentures issued by Canfor Corporation (Canfor) in November 1999 relating to the sale of Northwood Inc. These debentures were included in current assets in 2001.

At December 31, 2002, the ratio of net debt/total capitalization stood at 44%, up from 37% at year-end 2001. Net debt is defined as total debt plus bank advances less cash and short-term notes and the Canfor debentures. The Company is committed to reducing net debt in 2003 through internally generated cash flow and the sale of non-core assets. A key component of Nexfor's strategy is to maintain a strong balance sheet and the ability to access capital markets at favourable rates.

Book value per common share at December 31, 2002, was $5.30. Nexfor's shares traded on The Toronto Stock Exchange (TSX) in a range of CAD $9.70–$7.13 in 2002, closing the year at CAD $8.25, up 10% from year-end 2001. Including the dividend payment, Nexfor's total return to shareholders was 15%, significantly outperforming the main stock indices. The S&P/TSX Composite Index fell 14% in 2002. The new S&P/TSX Materials Index, consisting of 47 companies producing forest products, gold, steel, chemicals and base metals, rose 5%.

QUARTERLY INFORMATION

	Net Sales ($ millions)	*Earnings ($ millions)*	*Earnings per Common Share (basic)*	*Earnings per Common Share (diluted)*
2002				
4th Quarter	$ 384	$ (6)	$ (0.03)	$ (0.03)
3rd Quarter	374	4	0.02	0.02
2nd Quarter	385	12	0.08	0.08
1st Quarter	338	3	0.01	0.01
2001				
4th Quarter	$ 322	$ –	$ –	$ –
3rd Quarter	330	6	0.04	0.04
2nd Quarter	337	9	0.06	0.06
1st Quarter	329	(3)	(0.03)	(0.03)

NET SALES

Net sales increased 12% or $163 million in 2002, primarily due to the OSB and specialty papers acquisitions completed during the year. OSB accounted for 26% of total net sales in 2002 compared to 17% in 2001. The split of net sales by segment in 2002 was: North American Building Materials 44%, Paper and Pulp 41%, and European Panels 15%.

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
North American Building Materials	$ 654	$ 475	$ 432	$ 470	$ 389
European Panels [1]	227	208	234	155	160
Paper and Pulp	600	635	696	619	617
Subtotal	1,481	1,318	1,362	1,244	1,166
Operations sold	–	–	–	259	342
Total Net Sales	$ 1,481	$ 1,318	$ 1,362	$ 1,503	$ 1,508

(1) Includes 50% of Nexfor Ltd. (formerly CSC) until November 1999 and 100% thereafter.

Net sales from North American Building Materials increased 38% or $179 million in 2002 largely reflecting a 79% increase in OSB shipments. The three OSB mills acquired April 1 generated net sales of $99 million, accounting for over 60% of the 7 billion square feet (1/16-inch basis) increase in shipments. Continued ramp-up of the greenfield OSB mills in South Carolina and Alabama generated a $55 million increase in net sales over 2001. The industry benchmark North Central selling price averaged $159 per Msf (7/16-inch basis), down $1 from 2001.

In the European Panels segment, net sales increased 9% or $19 million. MDF mill nets firmed, averaging £119 per m^3 in 2002 compared to £115 in 2001. MDF shipments were up 9%, reflecting reduced market-related downtime. OSB shipments rose 2% as the expansion project completed in early 2001 generated record production in 2002 despite market-related downtime.

Paper and Pulp sales revenue fell 6% or $35 million. Groundwood paper sales were down $26 million, impacted by a slowdown in advertising and catalogue activity, an influx of European imports and substitution pressures from alternate grades. Pulp sales to third parties declined $12 million, as more of the hardwood kraft from the Thurso, Quebec, mill was used internally at the new paper mill in Gorham.

In terms of geographical distribution, the US is the principal market for Nexfor's products, with 73% of total sales in 2002. European sales represented 16% and Canadian 11%.

Shipments by Market	*Canada*	*United States*	*Europe*	2002 *Total*	*2001 Total*
OSB *(MMsf-1/16")*	1,491	14,609	1,757	17,857	10,744
Particleboard *(MMsf-1/16")*	–	–	3,317	3,317	3,566
MDF *(MMsf-1/16")*	128	802	2,302	3,232	3,054
Plywood *(MMsf-1/16")*	90	382	–	472	479
Lumber *(MMfbm)*	170	511	–	681	665
I-joist *(MM lineal ft.)*	–	30	–	30	27
Woodfree paper *(000 tonnes)*	13	356	–	369	362
Groundwood paper *(000 tonnes)*	5	173	–	178	186
Paperboard *(000 tonnes)*	44	8	–	52	51
Towel *(000 tonnes)*	–	17	–	17	–
Pulp *(000 tonnes)*	35	164	31	230	229

OPERATING EARNINGS

Operating earnings increased $6 million in 2002. Margin improvement initiatives and a positive contribution from the acquired OSB mills more than offset the negative impact of weaker pricing for most other products. A significant turnaround in results from the European Panels segment helped offset the deterioration in Paper and Pulp results. Total operating profit margins at 2% in 2002 were unchanged from the prior year.

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
North American Building Materials	$ 46	$ 35	$ 68	$ 139	$ 78
European Panels [1]	(2)	(20)	(6)	(1)	11
Paper and Pulp	(16)	7	52	(11)	(5)
Subtotal	28	22	114	127	84
Operations sold	–	–	–	48	14
Total Operating Earnings	$ 28	$ 22	$ 114	$ 175	$ 98

(1) Includes 50% of Nexfor Ltd. (formerly CSC) until November 1999 and 100% thereafter.

Operating earnings from North American Building Materials increased 31% in 2002 to $46 million. OSB accounted for 50% of the segment's 2002 results, generating operating earnings of $23 million or $7 million higher than 2001. The addition of the three new mills contributed half of the OSB increase. Lumber and woodlands generated operating earnings of $23 million in 2002 compared to $22 million in 2001. The 2002 results include an expense for duties on softwood lumber of $6 million, excluding the reversal of prior year accruals, compared to $3 million in 2001. The 2001 accrual of $3 million was reversed in 2002.

European Panels generated an $18 million improvement in operating results, recording a loss of $2 million in 2002 compared to a loss of $20 million in 2001. Firmer MDF prices complemented cost savings and production gains achieved through margin improvements. Benefits were also achieved from prior year restructurings.

Paper and Pulp posted a loss of $16 million in 2002, down $23 million from 2001. Lower prices for groundwood paper due to weak demand accounted for virtually all of the year-over-year profit decline.

EBITDA

Depreciation increased $26 million in 2002 to $121 million. Three major components of the increase were:

- Acquisition of three Southern OSB mills (+ $11 million).
- Start of depreciation at Alabama OSB mill (+ $9 million).
- Full-year depreciation at South Carolina OSB mill versus six months in 2001 (+ $4 million).

The New Hampshire paper and pulp facilities were acquired for a nominal amount and hence there was only a minimal impact on depreciation expense.

With higher operating earnings and depreciation, EBITDA increased 27% in 2002 to $149 million. North American Building Materials contributed 70% of the total 2002 EBITDA, Paper and Pulp 16%, and European Panels 14%. EBITDA as a percentage of net sales rose to 10% from 9% in 2001.

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
North American Building Materials	$ 104	$ 70	$ 98	$ 166	$ 104
European Panels [1]	21	–	17	12	22
Paper and Pulp	24	47	91	37	39
Subtotal	149	117	206	215	165
Operations sold	–	–	–	63	40
Total EBITDA	$ 149	$ 117	$ 206	$ 278	$ 205

(1) Includes 50% of Nexfor Ltd. (formerly CSC) until November 1999 and 100% thereafter.

SOFTWOOD LUMBER duties

On April 2, 2001, petitions for the imposition of antidumping duties (ADD) and countervailing duties (CVD) on softwood lumber from Canada were filed with the US Department of Commerce (DOC) and the US International Trade Commission (ITC) by certain US industry and trade groups.

In August 2001, the DOC issued its preliminary determination in the CVD investigation and imposed a preliminary duty of 19.3% on export sales of softwood lumber to the US. On October 31, 2001, the DOC imposed a preliminary ADD duty of 12.6% on Nexfor, being an average of the six companies reviewed.

The ITC announced May 16, 2002, it had found no current injury, but a threat of injury, to the US lumber industry, effectively removing the requirement to remit preliminary CVDs and ADDs. Consequently, in the second quarter of 2002, Nexfor reversed $3 million of duties accrued in 2001 and $2 million of duties accrued in the first quarter of 2002.

The finding by the ITC resulted in the DOC issuing an order to collect cash deposits of duties on a going forward basis. Effective May 22, 2002, certain of Nexfor's softwood lumber exports to the US have been subject to a CVD cash deposit rate of 18.8% and an ADD cash deposit rate of 8.4%. From May 22 through year-end, Nexfor incurred a charge of $2 million relating to CVD and $4 million relating to ADD. The expense for these duties is recorded in the financial statements as a reduction in net sales. Nexfor will continue to experience reduced revenues and margins in its North American Building Materials segment as a result of the duty applications.

The Government of Canada has challenged the duties with the World Trade Organization and under the North American Free Trade Agreement (NAFTA).

Twenty-five percent or 180 MMfbm of Nexfor's lumber capacity is located in the US and thus not subject to duties. Another 280 million feet of capacity is located at two sawmills in New Brunswick, a province exempt from the 18.8% CVD. Nexfor's two Quebec sawmills, with a combined capacity of 260 million feet, are subject to both duties, and shipped approximately 41% of their output to the US in 2002, down from 52% in 2001.

INTEREST

Interest expense increased $4 million in 2002 to $37 million, reflecting a higher average level of debt outstanding due to the OSB acquisition. Total long-term debt, including the current portion, increased to $812 million at year-end 2002, up 18% from $690 million at December 31, 2001. The effective interest rate on Nexfor's debt-related obligations, including the impact of interest rate swaps, was 4.5% at December 31, 2002. Nexfor benefited from the lowest US interest rates in four decades, with an average of 73% of its net debt outstanding during the year based on US floating rates.

During 2002, Nexfor realized a gain of $30 million in respect of $650 million of interest rate swaps. In 2001, a gain of $13 million was realized. These gains are deferred and amortized over the remaining term of the debt against which the swaps were designated as hedges. The amortization amounted to $9 million in 2002 and $2 million in 2001.

Interest and other income amounted to $6 million in 2002, identical to 2001. Both years include income of $3 million from the Canfor 6.25% convertible debentures.

INCOME taxes

A tax benefit of $16 million was recorded in 2002 on a pre-tax loss of $3 million. The effective tax rate was significantly different from the 42% combined statutory rate due to the low level of earnings, rate differences on international activities and a higher portion of income earned in lower tax jurisdictions.

SEGMENT results

Net assets employed by segment at year-end 2002, with 2001 in parentheses, are as follows:
- North American Building Materials 50% (42%)
- European Panels 16% (18%)
- Paper and Pulp 34% (40%)

North American Building Materials

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
Net sales	$ 654	$ 475	$ 432	$ 470	$ 389
Operating earnings	46	35	68	139	78
Depreciation	58	35	30	27	26
Capital expenditures	14	46	127	103	29

1998–1999 excludes sold operations.

The North American Building Materials segment comprises nine OSB mills, six sawmills, a specialty plywood plant, one MDF facility, an I-joist operation and 429,000 hectares of freehold timberlands. The operations, employing approximately 3,000 people, are located in three Canadian provinces and eight US states. The segment accounted for 44% of Nexfor's total net sales in 2002 compared to 36% in 2001.

	Net Sales ($ millions) 2002	2001	*Shipments (volumes)* 2002	2001	*Average Mill Nets ($ per M unit)* 2002	2001
OSB *(MMsf–1/16")*	$ 353	$ 195	16,100	9,015	22	22
Lumber *(MMfbm)*	168	159	681	665	247	239
Plywood *(MMsf–1/16")*	44	43	472	479	93	89
MDF *(MMsf–1/16")*	25	25	930	951	27	26
I-joist *(MM lineal ft.)*	23	20	30	27	755	752
Other (1)	41	33	–	–	–	–
Total	$ 654	$ 475				

(1) Other sales are primarily logs.

MARKETS

North American housing markets were hot in 2002. US housing starts increased 6% in 2002 to a 16-year high of 1.70 million units. The building boom was propelled by the lowest mortgage rates in four decades. Single-family starts, up 7% from 2001 and the strongest performance since 1978, continued to provide the foundation for the strong construction activity.

North American consumption of softwood lumber increased 4% in 2002, exceeding 63 billion board feet. Despite strong demand, lumber prices declined due to oversupplied markets. Log supply was up significantly due to the consumption of bug-infested wood in British Columbia, and forest fire salvage in many areas of the US. In addition, many mills tried to reduce per unit costs in response to the impact of the lumber duties by running flat out.

Lumber prices, as measured by Eastern Boston SPF, averaged $294 per Mfbm in the second half of 2002, down $50 from the first half average. For the full year, lumber prices averaged $319 per Mfbm, off 3% from 2001. At year-end 2002, the Eastern Boston price was in the $270 range. Great Lakes stud prices fared no better, also declining 3% year over year, averaging $334 per Mfbm in 2002.

The trade dispute between Canadian and US softwood lumber producers undercut normal market forces. The duties have not had the expected effect in the marketplace as prices declined, rather than increased. In response, a number of mills have taken extended downtime.

Supply also exceeded demand for OSB, keeping prices low through much of 2002. Additional production from ramp-ups at newer mills, an increase in imports from Europe and lower offshore shipments contributed to the imbalance. Although housing starts were strong, industrial, non-residential and mobile home demand were all well below previous year's levels.

North Central OSB prices averaged $159 US per Msf (7/16-inch basis) in 2002 down $1 from 2001. Little volatility was experienced during 2002 with quarterly average prices ranging between $156 and $163. Traditional seasonal strengths in the Spring and Summer months did not occur. Poor weather conditions, particularly in the Southwest, restricted building activity and led to industry-wide maintenance curtailments in the fourth quarter.

Commodity plywood continued to suffer from market share erosion to OSB. OSB's share of the North American structural panel market was approximately 56% in 2002 compared to 55% in 2001. OSB consumption hit a new record high of 22.7 billion square feet (3/8-inch basis) in 2002.

Markets for plywood overlay were relatively good in the first three quarters of 2002 but order files shrank in the fourth quarter. The normal seasonal slowdown combined with a surge of imports created an oversupplied North American market.

US consumption of MDF increased 7% in 2002 to a new record high reflecting the successful use of MDF in laminate flooring, mouldings and cabinets. However, markets did weaken in the fourth quarter. Overcapacity in particleboard kept MDF prices in check.

Low lumber prices slowed the penetration of I-joist in 2002.

OPERATIONS

Production	2002	*2001*	*2000*	*1999*	*1998*
OSB *(MMsf–3/8")*	16,053	9,054	7,620	7,047	6,957
Lumber *(MMfbm)*	696	664	559	502	479
Plywood *(MMsf–3/8")*	474	478	489	478	443
MDF *(MMsf–3/4")*	930	936	918	906	835
I-joist *(MM lineal ft.)*	31	26	7	–	–

Lumber and plywood production excludes sold operations in 1998 and 1999.

PANELS

The nine OSB mills recorded EBITDA of $65 million in 2002, generating an 18% return on net sales. EBITDA in 2001 was $33 million. OSB shipments increased 79% due to acquisitions, continued ramp-ups at the Alabama and South Carolina mills and record production from the Bemidji, Minnesota, plant and the two Quebec mills.

The three acquired Southern mills contributed EBITDA of $15 million for the nine-month ownership period in 2002 on sales of $99 million. Synergies realized to date were the result of a rationalization of product flows, elimination of high cost products and customer mix improvements. The mill at Cordele, Georgia, had the second-lowest cash cost of Nexfor's nine mills. A combined 21 days of production were lost at the two Texas mills in the third and fourth quarters due to lack of wood. Primary factors for this downtime were wet weather, which hampered logging activities and limited inventory capacity at each site.

The ramp-up at the Barton mill in Alabama has been the best of Nexfor's three recent OSB greenfield mills. Production at Barton, up over 400% from 2001, averaged 79% of design capacity in 2002. The mill began commercial production in August 2001. The mill at Joanna, South Carolina, which commenced operation in mid-2000, averaged 68% of capacity in 2002 versus 49% in 2001. Improvements initiated at the Barton mill will be implemented at Joanna. Successful resolution of press related issues at Joanna will significantly reduce operating costs and enhance profitability.

EBITDA margins from industrial panel operations averaged 17% in 2002, unchanged from 2001. MDF production at Deposit, New York, declined 1% from the 2001 record due to an extended maintenance shut in the fourth quarter. Mill nets for specialty plywood rose 4% to record highs, driven by a reduction in lower grade volume. A nine-day market-related shut was taken at the Cochrane, Ontario, plywood mill in December.

LUMBER/WOODLANDS

Lumber production increased 32 MMfbm or 5% in 2002. The Maine sawmills produced a record 196 MMfbm in 2002, up 12% from the previous high in 2000. The production increase was due mainly to the addition of a night shift at the Ashland, Maine, mill from May through December. The sawmill at Plaster Rock, New Brunswick, also set a new high. The La Sarre, Quebec, sawmill established a production record, averaging 235 Mfbm per shift or 5% above 2001's record.

EBITDA from lumber and woodlands totalled $36 million in 2002 versus $35 million in 2001. The results include duty expense of $3 million in 2002, net of prior year reversals, versus $3 million in 2001. The two Quebec sawmills, among the lowest-cost producers in Eastern Canada, generated an EBITDA of $14 million in 2002 despite the double burden of the CVD and ADD. All of Nexfor's sawmills were cash positive in 2002.

The I-joist plant at Juniper, New Brunswick, continued to increase its production levels in 2002, while operating during a lengthy strike. A second shift was added in February to meet market demand.

European Panels

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
Net sales	$ 227	$ 208	$ 234	$ 155	$ 160
Operating earnings (loss)	(2)	(20)	(6)	(1)	11
Depreciation	23	20	23	13	11
Capital expenditures	8	23	16	25	26

Financial data includes 50% of Nexfor Ltd. (formerly CSC) until November 1999 and 100% thereafter.

European Panels comprises one OSB plant, an MDF operation, two particleboard facilities, laminating operations and a furniture manufacturing facility. This segment, employing about 900 people, has operations in England and Scotland. European Panels accounted for 15% of Nexfor's total net sales in 2002, compared to 16% in 2001.

	Net Sales ($ millions)		*Shipments (MMsf–1/16")*		*Average Mill Nets ($ per M–1/16")*	
	2002	*2001*	2002	*2001*	2002	*2001*
OSB	$ 36	$ 34	1,757	1,729	21	20
MDF	61	51	2,302	2,103	27	24
Particleboard	63	66	3,317	3,566	19	18
Other [1]	67	57	–	–	–	–
Total	$ 227	$ 208	7,376	7,398		

(1) Other sales include laminated products, furniture components and ready-to-assemble furniture units.

MARKETS

The UK economy continued to perform well in 2002 as increased government spending filtered into construction markets. Housing demand was strong again with average house prices rising by 25%. Consumer confidence and demand held up well. The British pound remained strong against the Euro, negatively impacting British manufacturing, including the wood and furniture product industries.

OSB markets remained extremely competitive as new plants on the Continent continued to ramp up production. European demand grew by about 15% as OSB continued to displace both particleboard and plywood. Prices were flat compared to 2001, despite a firming at mid-year that failed to hold due to competition from the Continent and unfavourable exchange rates.

MDF markets improved in 2002. Supply and demand across Europe was in better balance as total consumption grew 4% and there was a slowdown in new plant openings. Average prices firmed marginally compared to 2001.

While the UK particleboard market is mature, the flooring sector benefited from the continuing strength of the UK housing market. However, further competition is coming from the furniture grade manufacturers whose market is suffering from imports. Nexfor exited the furniture grade business in 2000.

OPERATIONS

Production (1) *(MMsf–7/16")*	2002	2001	2000	1999	1998
OSB	1,867	1,745	1,500	826	758
MDF	2,216	2,190	2,143	815	704
Particleboard	3,363	3,389	4,237	2,535	2,421

(1) Production represents Nexfor's 50% ownership until November 1999 and 100% thereafter.

OSB production increased 7% in 2002 despite 16 days of market-related curtailments in December. Improvements continue to accrue from the expansion project completed in early 2001. Manufacturing costs were down 7% from 2001, through raw material and energy savings. EBITDA margins averaged 9% in 2002 compared to 2% in 2001.

One MDF line was shut for the first eight weeks of 2002 due to weak markets. Average mill nets firmed during the year with fourth quarter realizations 10% higher than the first quarter. The rising price reflected general market trends plus improved mix due to aggressive product refinements. Manufacturing costs declined 9% due to raw material and energy savings.

Substantial cost savings from the £18 million particleboard line rebuilt at Cowie in 2001 were realized in 2002, particularly from resin usage and increased recycled fibre content. Sales of Caberdek flooring reached record levels. Caberdek features a removable, slip-resistant waterproof film ensuring safer installation for builders. Manufacturing costs at the South Molton, England, particleboard plant were 9% lower than 2001, largely due to raw material savings.

Benefits also accrued from the 2001 closure of the lamination facility at South Shields, England, and restructuring at the South Molton value-added facility, which resulted in a streamlined product range and reduced head count.

Paper and Pulp

($ millions)	2002	2001	2000	1999	1998
Net sales	$ 600	$ 635	$ 696	$ 619	$ 618
Operating earnings (loss)	(16)	7	52	(11)	(5)
Depreciation	40	40	39	48	44
Capital expenditures	22	31	30	24	70

1998–1999 excludes sold operations.

The Paper and Pulp segment comprises 17 paper machines at four locations and one market pulp facility. A second pulp facility, acquired May 2002, is expected to begin operating in 2003. The segment employs about 3,200 people with operations in two Canadian provinces and four US states. Paper and Pulp accounted for 41% of Nexfor's total net sales in 2002, compared to 48% in 2001.

	Net Sales ($ millions) 2002	2001	*Shipments (000 tonnes)* 2002	2001	*Average Mill Nets ($ per tonne)* 2002	2001
Woodfree paper	$ 401	$ 390	369	362	1,086	1,078
Groundwood paper	130	156	178	186	733	842
Paperboard	26	27	52	51	509	524
Towel	12	–	17	–	683	–
Pulp	85	85	230	229	369	373
Intra-segment and other	(54)	(23)	–	–	–	–
Total	$ 600	$ 635	846	828		

MARKETS

Paper

In 2002, the North American paper industry failed to recover from the economic decline experienced in the previous year. As a result of weak demand, producers curtailed capacity. Imports were a significant competitive factor due to a strong US dollar. According to the American Forest & Paper Association (AF&PA), US paper and board producers permanently shut three million tons of capacity in 2002, up 4% from 2001. In addition, another 1.2 million tons of capacity were idled indefinitely – a 30% increase from the prior year.

US printing and writing paper capacity decreased 3% in 2002 to 27.3 million tons. The AF&PA forecasts 2003 US printing and writing capacity to remain essentially unchanged.

The AF&PA estimates overall US paper and board production totalled 89.5 million tons in 2002, a drop of 5.1 million tons from 2000. Printing and writing paper production was down 2.4 million tons over the two years.

With inconsistent demand in nearly every segment of the market, there were few price increases, and those that were implemented had to be phased in over two to three months. The hardest hit sector was publication papers. US magazine advertising pages declined 22% causing demand to plummet and putting intense pressure on newsprint, uncoated groundwood and coated groundwood paper grades. The price of lightweight coated groundwood fell to near 20-year lows.

Reported transaction prices for the benchmark coated groundwood No. 5 34-pound grade averaged $811 per ton in 2002, down 14% from 2001 and 21% from 2000. The price for commodity uncoated freesheet, No. 3 Offset 50-pound rolls, averaged $658 per ton in 2002, down 5% from 2001 and 10% from 2000.

Specialty paper markets continued to be less susceptible to swings in economic conditions.

Pulp

2002 began with very weak pulp conditions as the widely watched North American and Scandinavian (Norscan) producer inventories peaked at 1.87 million tonnes in January. The pulp market is generally viewed to be in balance at the 1.5 million tonne level. List prices for northern bleached hardwood kraft pulp bottomed at $430 per tonne in the first quarter due to poor paper markets and overcapacity in pulp. The second quarter featured strong shipments and seasonally related maintenance downtime as Norscan inventories dropped to a two-year low in June at 1.34 million

tonnes. Price increases were implemented monthly through the Spring and early Summer, boosting prices to $490 per tonne effective July 1. Conditions weakened in the latter part of the year with the less than robust performance of printing and writing papers, especially in Europe, which remains the single largest consumer of purchased pulp. Hardwood list prices declined $20 in November to $470. Norscan inventories ended 2002 at 1.64 million tonnes, after a 51,000 tonne decline in December.

Transaction prices for hardwood pulp, delivered into US markets, averaged $447 per tonne in 2002, down $45 from the prior year average. Prices had fallen steadily during 2001 due to a decline in paper demand fuelled by a large drop in advertising expenditures.

OPERATIONS

Production (000 tonnes)	2002	*2001*	*2000*	*1999*	*1998*
Woodfree paper	380	352	432	407	415
Uncoated groundwood paper	96	97	98	94	97
Coated groundwood paper	82	89	80	77	81
Paperboard	51	51	53	53	48
Towel	18	–	–	–	–
Pulp	237	224	238	238	228

Pulp production excludes sold operations in 1998 and 1999.

Paper

Nexfor's lightweight opaque business grew in 2002 with financial, pharmaceutical and bible papers up 12%, 10% and 22% respectively. Nexfor remains the leading supplier of bible papers in North America. Shipments of coated-one-side packaging paper rose 40%, benefiting from market leadership in quality and service for stain resistant grades. Text and cover sales grew 4% in a declining market.

Production at the Madawaska, Maine, paper mill totalled 407,000 tonnes in 2002, down 3,000 tonnes from 2001. No market-related downtime was required as the mill continued to benefit from its lighter weight offerings and capability to match product mix with market demand. Earnings were hit hard by the deterioration in groundwood paper markets. Average prices for Nexfor's coated and uncoated groundwood paper fell 15% and 14% respectively from 2001.

The Midwest paper operations continued to show expected improvement. Specialty grades represented 62% of the Midwest's shipments in 2002 compared to 47% in 2001. Production from the Midwest declined 18,000 tonnes from 2001. The mill at West Carrollton, Ohio, had produced 15,000 tonnes in 2001 prior to its permanent shut in March. EBITDA for the Midwest was $2 million in 2002, a $5 million improvement over 2001 and $12 million higher than 2000.

The paper mill at Gorham produced 41,000 tonnes of fine paper and 18,000 tonnes of industrial towel for the seven-month period of ownership, achieving commercial production at the end of October. All five paper machines were started during 2002. The landfill facility was sold in December for $10 million.

Pulp

Production at the Thurso hardwood mill averaged 667 tonnes per day, up 2% from 2001. Cash production costs declined 1% despite higher costs for fibre and oil.

Specialty sales increased 24% in 2002 to 108,000 tonnes, reducing exposure to the more volatile commodity grades. Shipments from Thurso to Nexfor's paper mills increased from 41,000 tonnes in 2001 to 75,000 tonnes in 2002. About 50% of the increase reflects shipments to the new paper mill at Gorham.

FOREST resources

Nexfor manages nearly 3 million hectares of forest land, principally in New Brunswick, Quebec and Maine, of which 429,000 hectares are freehold. Almost four million cubic metres of logs were harvested in 2002. The panel mills in the US and UK purchase all of their requirements from government lands and private woodlot owners. A total of 11 million seedlings were planted on owned and managed woodlands in 2002 to supplement natural regeneration.

LABOUR relations

Employees at the I-joist plant in Juniper voted in September 2002 to decertify the International Woodworkers Association of Canada (IWA). The plant, on strike since October 2001, had been operating with management and some bargaining unit employees who continued to work during the strike. Plant operations returned to normal following cessation of the strike.

Negotiations were completed in November 2002 with the IWA on a new five-year contract at the plywood mill at Cochrane. The unit had been without a contract since May 31, 2002. The new agreement provides for wage and benefit increases that are in line with other forest products agreements in the area.

One collective agreement covering approximately 850 employees is up for renewal in 2003. The current six-year contract with the United Paperworkers International Union at the Madawaska paper mill expires October 31. The Company intends to open discussions with the union early in 2003. Current negotiated settlements in the industry are in the range of 2.7%–3% per year depending on the length of the agreement.

Approximately 60% of Nexfor's 7,100 employees are unionized.

CAPITAL investments

Capital investments in 2002 totalled $44 million, a 10-year low, down 56% from 2001. Expenditures on North American Building Materials projects accounted for 32% of the total spending in 2002, European Panels 18%, and Paper and Pulp 50%. The 2002 total included $6 million invested at the three newly acquired OSB mills and paper and pulp complex in New Hampshire.

From 1998 to 2001, Nexfor invested more than $280 million in strategic capital, redeploying funds received from asset sales. Two greenfield OSB mills were built in the Southern US. In Scotland, the OSB mill was expanded by one-third and a particleboard line rebuilt. The major spending on greenfield projects has been completed. The investments will generate significant returns and value in coming years.

($ millions)	2002	*2001*	*2000*	*1999*	*1998*
Increased productivity	$ 17	$ 32	$ 21	$ 37	$ 87
Greenfield	–	34	114	92	10
Environmental	7	13	6	8	7
Maintenance of business	20	21	32	27	37
Total Capital Investments	$ 44	$ 100	$ 173	$ 164	$ 141

The Company's 2003 capital requirements are expected to be approximately $65 million. This target represents about half of depreciation. At year-end 2002, commitments to projects in progress amounted to only $7 million. About 45% of the 2003 capital will be directed at the five newly acquired mills. A major project to be undertaken in 2003 is a $12 million investment to improve the wood processing system at the Jefferson, Texas, OSB mill. Savings will be realized in increased wood recovery, lower resin and wax usage, and lower maintenance requirements. The need to replace this equipment was identified prior to the acquisition of the mill.

Approximately 50% of the 2003 program will be for sustaining capital – maintenance and environmental. The 2003 capital will be funded with cash generated from operations. Other funding sources also available include existing cash reserves and commercial paper. Depending on economic conditions, further strategic growth initiatives may be undertaken in 2003.

FINANCIAL instruments

Nexfor uses derivative financial instruments solely for the purpose of managing its interest rate and foreign exchange exposures, as detailed on page 29 in the Foreign Exchange section. These activities are governed by financial policies that cover risk identification, tolerance, measurement and reporting. Derivative transactions are executed only with approved counterparties under master netting agreements. Forward foreign exchange contracts and interest rate swaps are designated as hedges of specific exposures and accordingly, all gains and losses on these instruments are recognized in the same manner as the item being hedged. Further information about Nexfor's financial instruments is provided in notes 1, 6 and 13 to the consolidated financial statements.

LIQUIDITY and capital resources

Cash from operations, before non-cash working capital changes, totalled $114 million in 2002 compared to $77 million in 2001. The higher cash flow corresponds primarily to the increase in EBITDA. The Company continues to focus on optimizing its working capital requirements. Reductions in non-cash working capital items generated $32 million in 2002 versus $29 million in 2001. Free cash flow amounted to $102 million in 2002, up $96 million from 2001. Free cash flow is defined as cash provided by operating activities, including changes in non-cash working capital, less total additions to property, plant and equipment. The substantial improvement in free cash flow reflects higher EBITDA and a $56 million reduction in capital expenditures.

Net debt at December 31, 2002, totalled $697 million, up $172 million from year-end 2001. Net debt includes total debt of $812 million plus bank advances of $1 million less $116 million of cash and short-term notes and debentures of Canfor. The net debt/total capitalization ratio was 44% at December 31, 2002, compared to 37% at the previous year-end. In July 2002, the Company issued $250 million of 7.25% debentures maturing in 2012. The proceeds were used to repay other indebtedness, including the bridge financing incurred on the acquisition of the three Southern OSB mills.

There was no commercial paper outstanding at December 31, 2002, down from $118 million at year-end 2001. The total amount authorized under the commercial paper program, which is supported by committed term bank lines, is CAD $350 million or $225 million.

During 2002, the Company's committed term bank lines were renewed with each of its commercial banks. At December 31, 2002, $15 million of the Company's $293 million of committed bank lines was utilized. The balance of the bank lines is available to support the Company's short-term liquidity requirements, including its commercial paper program. The bank lines mature through 2008, have a weighted average term of 2.6 years, and bear interest at money market rates. In addition, the Company has access to a $100 million subordinated standby loan facility with a related company at market terms.

The next significant debt repayment is the $150 million 7.5% debenture issue due July 15, 2003. The Company has adequate available liquidity through its existing cash balances and its commercial paper program should free cash flow or asset sale proceeds be insufficient to repay this debenture. The $812 million term debt outstanding has an average term of 5.1 years.

In conjunction with the July 2002 debt issue, the Company entered into an interest rate swap agreement of $250 million that effectively converted the interest expense on the debentures from the 7.25% fixed rate to floating rates. During 2002, the Company realized a gain of $30 million (2001 – $13 million) in respect of $650 million (2001 – $400 million) of interest rate swaps. These gains are being deferred and amortized over the remaining term of the debt against which these swaps were designated as hedges. These swaps were replaced with new swaps of $525 million (2001 – $400 million) that effectively convert a portion of the Company's interest expense from fixed rates to floating rates. The terms of the swaps correspond to the terms of the underlying debt issues.

At December 31, 2002, 65% of Nexfor's net debt was at floating interest rates compared to 75% at year-end 2001.

At December 31, 2002, the Company had tax operating loss carryforwards of approximately CAD $88 million, $211 million and £51 million from Canadian, US and UK operations respectively. These losses may be carried forward to future years before they expire in 2008–2009 in Canada and 2020–2022 in the US. The UK losses may be carried forward indefinitely. Adjusting capital cost allowances claimed for income tax purposes in the year may extend the tax operating losses in Canada. The Company has capital losses in Canada of CAD $27 million that can be carried forward indefinitely. The Company also has approximately CAD $47 million of Investment Tax Credits (ITCs) available to reduce future Canadian tax liabilities. The ITCs expire between 2007 and 2011. The tax benefit of the ITCs on qualified fixed assets has been reflected in the financial statements as a reduction in the book value of the assets to which they relate. The loss carryforwards and the credits will be utilized over the next several years to eliminate cash taxes otherwise payable, and will enhance future cash flows. The future tax benefits of these temporary differences have been included in future income taxes in the consolidated financial statements.

DEFINED BENEFIT pension plans

Nexfor's obligations under its defined benefit pension plans are determined periodically through actuarial valuations, which are the basis for calculating pension expense. At Nexfor's measurement date of September 30, defined benefit pension plan assets were $280 million (2001 – $316 million) while the accrued benefit obligations were $405 million (2001 – $379 million). The funded status of Nexfor's defined benefit pension plans has deteriorated from 2001 primarily due to poor investment returns and lower discount rates. Given the market rally in the fourth quarter, Nexfor's assets were $12 million higher at December 31, 2002. Defined benefit pension expense for the year was $9 million (2001 – $1 million) and defined benefit employer contributions were $13 million (2001 – $12 million). Nexfor's defined benefit pension plans are funded in accordance with all applicable regulatory requirements.

The assumed return on assets is 8% and is based on management's best estimate of the long-term expected rate of return on plan assets, including consideration of asset mix, equity risk premium, plan expenses and active investment management premium. The discount rate is 6.5% or 6.75%, depending on the plan, and is based on the market yield of high-quality corporate bonds of similar duration to the pension plan liabilities. Sensitivity to a 1% decrease in these two key assumptions is estimated as follows:

	Impact on September 30, 2002 Funded Status	*Impact on 2002 Pension Expense*
Return on assets	none	$3 million increase
Discount rate	$42 million decrease	$1 million increase

CREDIT ratings

Debt ratings within investment grade categories are a key objective of Nexfor's financing strategy and provide for long-term access to public and private capital markets at attractive terms and conditions. Current ratings are:

	Dominion Bond Rating Service	*Standard & Poor's*	*Moody's Investors Service*
Commercial paper	R-1 (low)		
Debentures	BBB	BBB	Baa2
Preferred shares	Pfd-3	BB+	

STOCK-BASED compensation

Effective 2002, the Company began accounting for its stock option plans in accordance with recommendations promulgated by The Canadian Institute of Chartered Accountants. These recommendations have been applied prospectively.

The Company accounts for stock options using the fair value method. Under this method, compensation expense for options is measured at the grant date using an option pricing model and recognized on a straight-line basis over the vesting period.

During 2002, the Company recognized $1 million in compensation expense related to stock options, which is included in selling, general and administrative costs in the statements of earnings.

At year-end 2002, options on 5.1 million shares were outstanding at a weighted average exercise price of CAD $7.63. Options were granted on 1.2 million shares during 2002 and exercised and/or cancelled on 57,900 shares.

COMMON shares

Under the Dividend Reinvestment Plan, 2,814,200 common shares were issued in 2002 compared to 812,500 in 2001. Since the fourth quarter of 2001, Nexfor's major shareholder, Brascan Corporation, has elected to take dividends in shares in lieu of cash. At December 31, 2002, Brascan owned 42.6% of Nexfor's outstanding common shares compared to 41.5% at year-end 2001.

No shares were repurchased by the Company in 2002. In 2001, 63,600 shares were purchased at an average cost of CAD $6.70. Since 1997, 15.6 million shares have been purchased and cancelled at a cost of $78 million.

Common Share Information	2002	*2001*	*2000*	*1999*	*1998*
Shares outstanding at year-end *(000's)*	144,450	141,561	140,307	151,217	153,706
Dividends *($ millions)*	$ 36	$ 36	$ 36	$ 39	$ 40
Book value	$ 5.30	$ 5.50	$ 5.65	$ 5.24	$ 4.42
Market price at year-end *(CAD $)*	$ 8.25	$ 7.50	$ 7.10	$ 8.40	$ 6.05
Dividend yield	4.8%	5.3%	5.6%	4.8%	6.6%

DIVIDENDS

Nexfor manages its business to allow a sustainable quarterly dividend to be paid on the common shares throughout the business cycle. The Board of Directors has declared regular quarterly common dividends of CAD $0.10 per share since the fourth quarter of 1990. Dividends to common shareholders amounted to $36 million in 2002; $20 million was paid in cash and $16 million issued in shares under the Dividend Reinvestment Plan.

Preferred share dividends totalled $2 million in 2002, unchanged from 2001. Preferred share capital outstanding at year-end 2002 totalled 2.4 million shares or $38 million.

RISKS and uncertainties

Nexfor is exposed to a number of risks in the normal course of its business that have the potential to affect the operating performance of the Company. Major risks are discussed below.

PRICE SENSITIVITIES

Nexfor's earnings are sensitive to changes in world economic conditions, primarily in North America and Europe. Forest products markets are competitive and cyclical in nature and prices for many products are sensitive to variations in supply and demand.

Based on operating at capacity, the following table shows the approximate annualized impact on after-tax earnings of changes in product prices.

	Sensitivity Factor $	*Impact on Earnings ($ millions)*	*Average Mill Nets 4th Qtr. 2002*
North American OSB	$10 per Msf–7/16"	$ 18	$ 154
Other panels	$10 per Msf–7/16"	9	199
Lumber	$10 per Mfbm	5	208
Woodfree paper	$50 per tonne	16	1,078
Groundwood paper	$50 per tonne	6	736
Market pulp*	$25 per tonne	–	382

**Excludes Berlin mill, which is scheduled to start operation in 2003.*

FOREIGN EXCHANGE

Nexfor's businesses compete within North American and European markets where product prices are significantly influenced by US dollar and Euro exchange rates. Nexfor's exposure to foreign exchange rate fluctuations changed in the fourth quarter of 2002 given the change in functional currency of the Canadian operations and the concurrent adoption of the US dollar as Nexfor's reporting currency.

Accordingly, Nexfor's foreign exchange exposure now arises from the following sources:

- Net investments in self-sustaining foreign operations, now limited to Nexfor's investment in its UK operations.
- Net Canadian dollar-denominated monetary assets and liabilities.
- Committed or anticipated foreign currency transactions, primarily Canadian dollar costs in Nexfor's Canadian operations and Euro revenues in Nexfor's UK operations.

Nexfor's policy is to hedge all significant balance sheet foreign exchange exposures. The Company also hedges a portion of net foreign currency cash flows for periods up to three years in order to reduce the potential negative effect of a strengthening Canadian dollar versus the US dollar or a strengthening British pound versus the Euro.

In 2002, Nexfor benefited from a weaker Canadian dollar, realizing an average exchange rate, relative to the US dollar, of US $0.637 (2001 – US $0.659) on its net US dollar cash flows prior to the change in reporting currency and thereafter on its Canadian dollar cash flows. This rate includes the effect of $196 million (2001 – $313 million) of US dollar revenue hedges at an average rate of US $0.641 (2001 – US $0.667) prior to the change in reporting currency and thereafter CAD $60 million of Canadian dollar cost hedges at an average rate of US $0.641.

The Euro strengthened on average versus the British pound from £0.621 in 2001 to £0.629 during 2002 benefiting the UK operations. Notwithstanding this, Nexfor's UK operations have continued to suffer from the relative strength of the pound.

At December 31, 2002, Nexfor had entered into CAD $108 million of forward foreign exchange contracts as a hedge of its Canadian dollar cost exposure. These agreements mature at various dates to October 15, 2003, at an average exchange rate of US $0.637. These contracts represent about 18% of the expected net Canadian dollar costs in 2003. Giving effect to these hedges, each US one-cent change in the value of the Canadian dollar will impact annualized after-tax earnings by approximately $3 million in 2003. This compares with an impact of approximately $4 million if these contracts were not in place.

ABORIGINAL LAND CLAIMS

In July 1998, a lawsuit was launched by the Cree Nation in Northern Quebec against the federal and provincial governments and forest product companies operating in the region, including Nexfor. The lawsuit claimed that forestry on Aboriginal lands threatened the traditional Cree way of life protected under the James Bay and Northern Quebec Agreement signed in 1974.

The case was resolved February 1, 2002, outside of court with an agreement between the Cree Nation and the Quebec government. The agreement encompassed the management of all natural resources, however, several details about forestry still have to be resolved. While the impact cannot be fully measured until those discussions are completed, the agreement will affect the timber allocations and harvesting costs for Nexfor's operations in Quebec.

ENVIRONMENTAL ISSUES

Nexfor's operations are subject to a wide range of general and industry-specific environmental laws and regulations, with respect to air emissions, wastewater discharges, solid and hazardous waste management, plant and wildlife protection, and site remediation.

The Canadian federal government is proposing a 6% reduction in greenhouse gas emissions by 2012. Nexfor supports a climate-change process to reduce greenhouse gas emissions if applied on an equitable basis. Assuming that the forest products sector receives credit for the emissions reductions made from 1990 levels, we do not expect significant capital investments will be necessary to comply with the recommendation.

The US Environmental Protection Agency (EPA) is in the process of developing and receiving federal approval on Maximum Achievable Control Technology (MACT) regulations to control 188 hazardous air pollutants. The new regulations will impact Nexfor's OSB and MDF operations in the US. A final ruling is expected on the EPA proposals in February 2004, following which mills will have three years to comply. A more detailed discussion on the expected MACT impact on Nexfor's operations can be found on page 61 of this annual report.

The OSB mill at Joanna received a notice of violation in 2002 relating to non-compliance with permitting regulations for volatile organic compound (VOC) emissions. The resulting penalty from the State of South Carolina is not expected to be material. To rectify the situation, process modifications have been implemented and Nexfor has been working with the state to adjust its permit criteria.

Following the March 2001 closure of the paper mill at West Carrollton certain environmental conditions were identified relating to site clean-up costs. During 2002, environmental tests were conducted that indicate the presence of soil contamination. Nexfor continues to work with the mill's previous owner and state officials to resolve all issues. Costs of remediation are not yet determinable. However, Nexfor believes that any remediation costs will be recoverable from the previous owner.

Forest certification efforts continued in 2002. The Plaster Rock and Levesque, Maine, sawmills became the first manufacturers to stamp their lumber with the product label of the AF&PA's SFI program. North American wood procurement and woodland operations successfully passed their final SFI pre-audit and expect to be certified by March 2003.

OUTLOOK for 2003

NORTH AMERICAN BUILDING MATERIALS

Homebuilding is expected to cool somewhat from the strong levels of 2002. US housing starts are projected at 1.63 million in 2003, down 4% from 2002. Starts have averaged 1.63 million in the past five years. With no near-term pressure on mortgage rates, housing demand is expected to remain relatively strong for the near to medium term.

Although housing starts are expected to fall, some resurgence in industrial demand is anticipated. In addition, OSB capacity additions will be minimal and further plywood closures are expected.

Lumber and OSB prices are expected to remain weak in the first quarter as normal seasonal slowdowns affect building activity. Field inventories, however, are lean and builders may find it difficult to resist purchasing some inventory at depressed prices.

Nexfor's OSB production is expected to rise approximately 15% in 2003 with a full year's output from the three mills acquired in April 2002 and ramp-ups from the two greenfield mills. The focus on increasing value-added sales will intensify.

Lumber markets will continue to be affected by the softwood trade dispute either with the continuation of the duties or with a negotiated settlement. Efforts to resolve the dispute through a series of proposals were ongoing in 2002 and into 2003. A framework for a negotiated settlement however remains elusive. A challenge to both the CVD and ADD has been filed by the Canadian government under the terms of NAFTA. A NAFTA panel is expected to rule on this challenge in 2003. Resolution of the dispute in 2003 could act as a significant positive catalyst for the lumber sector.

EUROPEAN PANELS

In 2002, European Panels operating results improved $18 million over 2001. Further improvement is expected in 2003. The focus will again be on controllable costs through aggressive margin improvement initiatives. The relative strength of the British pound versus the Euro, however, will continue to be a factor in the profitability of the segment.

European demand for OSB is expected to grow a further 15% in 2003. OSB continues to find favour among builders and other end-use sectors due to its ready availability, consistently superior engineered properties and price. The mill at Inverness, Scotland, expects to increase sales by 10% in 2003, both in the UK and on the Continent. Pricing is expected to remain competitive, especially in the first half of 2003.

Market conditions for MDF will remain competitive in 2003 as several competitors in Western Europe ramp up new capacity and demand growth is constrained by weakness in continental economies, particularly Germany's. Nexfor expects average mill nets to increase 5% over 2002, mainly a reflection of mix improvements.

Particleboard costs should continue to improve with the ramp-up of the rebuilt line at Cowie through its continuous press technology. Benefits will also accrue from increased recycle content in the fibre mix and revenue generated through tax credits. Any price improvements will come from further refinements in the product mix.

PAPER AND PULP

Coated groundwood prices, at current unsustainable levels, have limited downside risk. The recent strengthening of the Euro relative to the US dollar will improve the competitive position of North American producers. A stronger economy will also translate into increased paper consumption.

2003 began with a flurry of pulp pricing announcements. A number of producers announced price hikes of $20 per tonne in North America and $40 in Europe. Working in favour of firmer pulp prices was the growing problem of reduced pulpwood availability in the US South, largely due to wet weather. Eastern Canada also experienced less

availability of residual chips as sawmills took downtime due to low lumber prices. Rising pulp prices are historically a precursor to paper price increases.

Nexfor has announced its intent to sell the Thurso pulp mill, a business considered to be non-strategic. The pulp mill at Berlin is scheduled to start up in 2003. Once Berlin is running full out and Thurso is sold, Nexfor will be 95% self-sufficient in pulp. While virtually all pulp requirements will be sourced internally, there will be external trades of hardwood grades for softwood. Procurement of roundwood for the Berlin mill is expected to be competitive as loggers in the area have downsized.

In 2003, lightweight opaque paper markets should be buoyed by financial printing growth as the economy improves, by pharmaceutical growth as new font sizes are regulated, and by publishers moving to lighter basis weights due to postal rate hikes. Continued growth is expected in Nexfor's leadership position in coated packaging grades.

Improvement in product mix, the successful launch and development of new grades, and cost containment will be keys to returning the Paper and Pulp segment to profitability in 2003. Price increases by mid-year will be an added bonus.

SUMMARY

Financial results in 2002 fell short of expectations. It is anticipated that 2003 will be another challenging year for the forest products industry. Some market-related downtime may be required to keep inventories in line, particularly in the early part of the year. We agree with the consensus of economists, projecting that economic growth will gradually pick up steam as the year progresses.

Nexfor's financial goals and operational priorities for 2003 include:
- Maximize free cash flow.
- Integrate 2002 acquisitions.
- Continue aggressive MIP.
- Reduce debt.
- Maintain financial flexibility and liquidity.

We will continue to position the Company conservatively in the event that the recoveries in markets for building materials, paper and pulp take longer than anticipated. We expect to complete the sale of some non-strategic assets in 2003.

We'll focus on the controllable aspects of our business. MIP will continue to be of critical importance. We're committed to generating a minimum of $34 million from these initiatives in 2003. We're accelerating our product development process, sharing best practices with acquired mills and striving for world class status in safety performance. Capital spending will be constrained but we'll also continue to evaluate acquisition opportunities.

Nexfor's financial condition continues to be strong. Cash flow from operations in 2003 is expected to be sufficient to fund capital spending as well as interest and dividend requirements. The $150 million debt maturity in July will be funded by asset sale proceeds, available cash or the issuance of commercial paper backed by committed term bank lines. Undrawn committed term bank lines amounted to $278 million at December 31, 2002, and cash balances totalled $67 million. In addition, $49 million of marketable debentures are held and the public and private debt markets are open to the Company.

We are well positioned for earnings growth as the economy shows more consistent, broad-based improvement.

MANAGEMENT'S RESPONSIBILITY FOR the financial statements

The accompanying consolidated financial statements and all information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based upon estimates and judgements. When alternative methods exist, management has chosen those it deems to be the most appropriate in the circumstances. The financial information presented elsewhere in this annual report is consistent with that in the financial statements.

Management is responsible for establishing and maintaining adequate internal controls. Management believes that Nexfor maintains effective internal controls over financial reporting, which are designed to permit the accurate and timely preparation of financial statements in accordance with generally accepted accounting principles in Canada.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board and reviews the financial statements and management's discussion and analysis; considers the report of the external auditors; assesses the adequacy of the internal controls of the Company; examines the fees and expenses for audit services; and recommends to the Board the independent auditors for appointment by the shareholders. The Committee reports its findings to the Board of Directors for consideration when approving the financial statements for issuance to the shareholders.

January 20, 2003

DOMINIC GAMMIERO
President & Chief Executive Officer

JOHN TREMAYNE
Senior Vice President & Chief Financial Officer

AUDITORS' report

To the Shareholders of Nexfor Inc.

We have audited the consolidated balance sheets of Nexfor Inc. as at December 31, 2002 and 2001, and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
January 20, 2003

Ernst & Young LLP
Chartered Accountants

CONSOLIDATED balance sheets

Years ended December 31 *(US $ millions)*	2002	2001
ASSETS		
Current assets:		
Cash and short-term notes	$ 67	$ 116
Temporary investments (NOTE 5)	–	49
Accounts receivable	182	170
Inventory (NOTE 3)	181	161
Future income taxes (NOTE 9)	13	15
	443	511
Property, plant and equipment (NOTE 4)	1,439	1,266
Other assets (NOTE 5)	80	18
Future income taxes (NOTE 9)	7	–
	$ 1,969	$ 1,795
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank advances	$ 1	$ –
Accounts payable and accrued liabilities (NOTE 14)	264	206
Current portion of long-term debt (NOTE 6)	153	3
	418	209
Long-term debt (NOTE 6)	659	687
Other liabilities (NOTE 12)	80	61
Future income taxes (NOTE 9)	12	24
Shareholders' equity (NOTE 7)	800	814
	$ 1,969	$ 1,795

(See accompanying notes)

On behalf of the Board:

K. LINN MACDONALD
Chairman

DOMINIC GAMMIERO
President & Chief Executive Officer

CONSOLIDATED STATEMENTS of earnings and retained earnings

Years ended December 31 *(US $ millions, except per share information)*	2002	2001
EARNINGS		
Net sales	$ 1,481	$ 1,318
Operating costs:		
Cost of sales	1,271	1,144
Depreciation	121	95
Selling, general and administrative (NOTE 7)	61	57
	1,453	1,296
Operating earnings	28	22
Interest and other income (NOTE 5)	6	6
Interest expense (NOTE 6)	(37)	(33)
Income tax recovery (NOTE 9)	16	17
Earnings	$ 13	$ 12
Earnings per common share (NOTES 2 AND 8) – Basic	$ 0.08	$ 0.07
– Diluted	$ 0.08	$ 0.07
RETAINED EARNINGS		
Balance, beginning of year	$ 194	$ 220
Earnings	13	12
Preferred share dividends	(2)	(2)
Common share dividends	(36)	(36)
Balance, end of year	$ 169	$ 194

(See accompanying notes)

CONSOLIDATED STATEMENTS of cash flows

Years ended December 31 (US $ millions)	2002	*2001*
CASH PROVIDED BY (USED FOR):		
OPERATING ACTIVITIES		
Earnings	$ 13	$ 12
Items not affecting cash:		
Depreciation	121	95
Future income taxes (NOTE 9)	(22)	(22)
Other items	2	(8)
Cash provided by operations	114	77
Net change in non-cash working capital balances (NOTE 10)	32	29
	146	106
INVESTMENT ACTIVITIES		
Additions to property, plant and equipment	(44)	(100)
Investments and other (NOTE 11)	(288)	(38)
	(332)	(138)
FINANCING ACTIVITIES		
Issue of 7.25% debentures (NOTE 6)	250	–
Other debt repaid, net (NOTES 6 AND 10)	(115)	(97)
Issue of 8.125% debentures (NOTE 6)	–	200
Term debt repayments (NOTE 6)	–	(37)
Dividends	(22)	(34)
Realized interest rate swap gain (NOTE 6)	30	13
Foreign exchange due to change in accounting policy (NOTE 2)	(6)	(3)
	137	42
Increase (decrease) in cash and short-term notes	$ (49)	$ 10

(See accompanying notes)

NOTES TO the consolidated financial statements

(in millions of US dollars, except per share information)

In these notes "Nexfor" means Nexfor Inc. and all of its consolidated subsidiaries and affiliates, and "Company" means Nexfor Inc. as a separate corporation.

NOTE 1. accounting policies

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Nexfor's interests in investments in which it has significant, but less than controlling interests, are accounted for by the equity method.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses during a period. Actual results could differ from those estimates.

VALUATION OF INVENTORIES

Inventories of raw materials and operating supplies are valued at the lower of average cost and replacement cost or net realizable value. Inventories of manufactured products are valued at the lower of average cost and net realizable value.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost and are depreciated on a straight-line basis. The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over the following periods that approximate their useful lives:

Buildings	20 to 40 years
Sawmills and panelboard production equipment	10 to 15 years
Paper and pulp mill machinery and production equipment	20 years
Logging machinery and equipment	4 to 10 years

Silviculture costs on owned timberlands are capitalized. Depletion of timber is determined on an appropriate basis related to log production and included in depreciation. Interest is capitalized on major capital projects during construction. Costs, net of revenues, incurred during the start-up period of major capital projects are deferred as other assets and amortized over the early productive life of the project.

EMPLOYEE FUTURE BENEFITS

Nexfor sponsors various defined benefit and defined contribution pension plans, which cover substantially all employees and are funded in accordance with applicable plan and regulatory requirements. Nexfor also provides a variety of non-pension post-retirement benefits to eligible retirees, including life insurance, medical and dental benefits, which are funded on a pay-as-you-go basis.

The obligations associated with these benefit plans are actuarially valued using the projected unit credit method pro-rated on services, management's best estimate assumptions for expected investment performance, salary escalation, health care cost trend rates, and a current market discount rate. Plan assets are measured at fair value. Prior service costs related to plan amendments and transitional assets are amortized on a straight-line basis over the estimated average remaining service lives (EARSL) of the employee groups. The net actuarial gains or losses in excess of 10% of the greater of the accrued benefit obligation and the fair value of plan assets are amortized on a straight-line basis over EARSL.

REVENUE RECOGNITION

Net sales are recognized when the risks of ownership pass to the purchaser. This is generally when goods are shipped.

STOCK OPTIONS

Effective January 1, 2002, the Company began accounting for its stock option plans in accordance with recommendations promulgated by The Canadian Institute of Chartered Accountants. These recommendations have been applied prospectively.

The Company accounts for stock options using the fair value method. Under the fair value method, compensation expense for options is measured at the grant date using an option pricing model and recognized in earnings on a straight-line basis over the vesting period.

TRANSLATION OF FOREIGN CURRENCIES

During the fourth quarter of 2002, the United States dollar (US dollar) became the functional currency of Nexfor's Canadian operations and Nexfor adopted the US dollar as its reporting currency (note 2).

Prior to the change in reporting currency, the accounts of subsidiaries having a functional currency other than the Canadian dollar were translated using the current rate method under which assets and liabilities are translated at the exchange rate prevailing at the year-end and revenues and expenses at average rates during the year. Gains or losses on translation were not included in the consolidated statements of earnings but were deferred and shown as a separate item in shareholders' equity. Gains or losses on foreign currency-denominated balances and transactions that were designated as hedges of net investments in these subsidiaries were reported in the same manner as translation adjustments.

Gains or losses on forward foreign exchange contracts that served to hedge future US dollar-denominated net sales were recognized at their settlement dates and were recorded in net sales.

Subsequent to the change in reporting currency, the accounts of subsidiaries having a functional currency other than the US dollar are translated using the current rate method. Gains or losses on translation are deferred and shown as a separate item in shareholders' equity. Gains or losses on foreign currency-denominated balances and transactions that are designated as hedges of investments in these subsidiaries are reported in the same manner as translation adjustments.

Foreign currency-denominated monetary assets and liabilities of subsidiaries where the functional currency is the US dollar are translated at the rate of exchange prevailing at year-end. Gains or losses on translation of these items are included in the consolidated statements of earnings. Gains or losses on transactions which hedge these items are also included in the consolidated statements of earnings.

Gains or losses on forward foreign exchange contracts that serve to hedge future Canadian dollar-denominated costs are recognized at their settlement dates and are included in cost of sales.

FINANCIAL INSTRUMENTS

The carrying values of financial instruments approximate fair value, except where disclosed in these notes. Fair values disclosed are determined using actual quoted market prices or, if not available, indicative prices based on similar publicly traded instruments.

NOTE 2. change in accounting policy

During the fourth quarter of 2002, the US dollar became the functional currency of Nexfor's Canadian operations as a result of the increase in US dollar-denominated expenditures of those operations as compared to prior years. Concurrent with this change in functional currency, Nexfor adopted the US dollar as its reporting currency. Under Canadian GAAP, the change in reporting currency was effected using the translation of convenience method whereby all historical financial transactions and balances are translated into US dollars using the exchange rate in effect on the date of changing the reporting currency. The exchange rate used to translate historical balances and transactions was CAD $1.00 = US $0.6380.

US dollar-denominated issues and repayments of debt in the consolidated statements of cash flows and balances in note 6, long-term debt, have been reflected at their actual amounts with foreign exchange adjustments due to the use of the translation of convenience method separately identified.

NOTE 3. inventory

		2002		2001
Logs, pulp chips and pulpwood	$	29	$	35
Paper and pulp products		64		47
Lumber, panel products and other building materials		36		37
Operating and maintenance supplies		52		42
	$	181	$	161

NOTE 4. property, plant and equipment

					Net Book Value		
		Cost		*Accumulated Depreciation*		2002		2001
Building materials	$	1,463	$	544	$	919	$	723
Paper and pulp		1,085		629		456		477
Timber and timberlands		87		33		54		52
Construction in progress		9		–		9		13
Other		2		1		1		1
	$	2,646	$	1,207	$	1,439	$	1,266

NOTE 5. other assets

Other assets includes a $49 convertible subordinated debenture of Canfor Corporation (Canfor). The debenture has a face value of CAD $78, bears interest at 6.25%, is due on November 23, 2006, and is redeemable by Canfor if certain conditions are met. The debenture is convertible into common shares of Canfor at a conversion price of CAD $13.20 per share.

NOTE 6. long-term debt

		2002		2001
NEXFOR INC. AND ITS WHOLLY-OWNED SUBSIDIARIES				
7.5% debentures due 2003	$	150	$	150
6.875% debentures due 2005		200		200
8.125% debentures due 2008		200		200
7.25% debentures due 2012		250		–
Other debt		6		3
Commercial paper and bank term loans (2001 – CAD $186)		–		119
JOINT VENTURES				
Environmental bonds due to 2025		6		6
Bank term loans		–		2
Foreign exchange due to change in accounting policy (NOTE 2)		–		10
		812		690
Current portion of long-term debt		(153)		(3)
	$	659	$	687

Maturities of long-term debt at December 31, 2002, are: 2003 – $153; 2004 – $1; 2005 – $201; 2006 – nil; 2007 – nil and subsequent – $457.

Commercial paper and bank term loans include short-term borrowings, which are classified as long-term debt as they are supported by $293 of committed term bank lines expiring through 2008 and bear interest at various money market rates. At December 31, 2002, $15 of these lines had been utilized, with the balance available to support the Company's short-term liquidity requirements. In addition, the Company maintains a $100 subordinated stand-by loan facility with a related company at market terms.

During the year, the Company issued $250 of debentures maturing July 2012. The proceeds were used to pay other indebtedness. In conjunction with the issue of the debentures, the Company entered into interest rate swap agreements of $250 that effectively converted the interest expense on the debentures to floating rates. The terms of these swaps corresponded to the terms of the debentures.

During the year, the Company realized a gain of $30 (2001 – $13) in respect of $650 (2001 – $400) of interest rate swaps. These gains are being deferred and amortized over the remaining term of the debt against which these swaps were designated as hedges. These swaps were replaced with new swaps of $525 (2001 – $400) that effectively convert a portion of the Company's interest expense from fixed rates to floating rates. The terms of the swaps correspond to the terms of the underlying debt issues.

The effective interest rate on Nexfor's debt-related obligations is 4.5% at December 31, 2002 (2001 – 4.16%). The aggregate fair value of Nexfor's debt is $812, consisting of debt of $862 and gains on interest rate swaps of $50.

Interest expense on long-term debt for the year was $37 (2001 – $33). Total interest paid during the year was $29 (2001 – $33), including interest capitalized on plant and equipment under construction of nil (2001 – $4).

NOTE 7. shareholders' equity

	2002	*2001*
Capital stock:		
2,400,000 Class A preferred shares Series I	$ 38	$ 38
144,449,875 common shares (2001 – 141,560,707)	583	567
Retained earnings	169	194
Foreign exchange translation adjustment	12	17
	802	816
Executive share purchase plan loans	(2)	(2)
	$ 800	$ 814

As at December 31, 2002, the authorized capital stock of the Company is as follows:

- Class A preferred shares, an unlimited number; 20,000,000 Series 1, bearing dividends at 72% of prime plus an adjustment factor (currently 28% of prime), cumulative and redeemable at issue price.
- Class B preferred shares, an unlimited number.
- Non-voting participating shares, an unlimited number.
- Common shares, an unlimited number.

Summary of common share transactions:

	2002 Shares	2002 Amount	2001 Shares	2001 Amount
Balance, beginning of year	141,560,707	$ 567	140,306,593	$ 561
Dividend reinvestment plan	2,814,168	16	812,478	4
Issue of common shares	75,000	–	505,275	2
Repurchase & cancellation of common shares	–	–	(63,639)	–
Balance, end of year	144,449,875	$ 583	141,560,707	$ 567

Loans receivable from officers of $2 (2001 – $2) under the Company's executive share purchase plan are included as a reduction of shareholders' equity. The loans mature in 2008 through 2012, are callable by the Company at any time, and are secured by a pledge of 636,875 (2001 – 607,375) common shares.

Under the Company's stock option plan, the Board of Directors of the Company may issue stock options to certain directors and employees of Nexfor. These options vest over a 5-year period and expire 10 years from the date of issue. Included in selling, general and administrative costs is $1 (2001 – nil) related to these options.

The following table summarizes the changes in options outstanding during the year:

	2002 Shares	2002 Weighted Average Exercise Price (CAD $)	2001 Shares	2001 Weighted Average Exercise Price (CAD $)
Balance, beginning of year	3,924,750	$ 7.53	3,152,100	$ 7.87
Options granted	1,205,100	7.98	1,180,500	6.90
Options exercised	(18,800)	6.56	(16,000)	6.13
Options cancelled	(39,100)	7.87	(47,600)	8.15
Options expired	–	–	(344,250)	8.51
	5,071,950	$ 7.63	3,924,750	$ 7.53
Exercisable at year-end	1,952,510	$ 7.77	1,201,800	$ 7.92

Options exercised include nil (2001 – 3,400) options settled through the issuance of shares.

The following table summarizes the weighted average exercise prices and the weighted average remaining contractual life of the options outstanding at December 31, 2002.

Range of Exercise Prices (CAD $)	*Options Outstanding*	*Weighted Average Remaining Contractual Life*	*Weighted Average Exercise Price (CAD $)*	*Options Vested*	*Weighted Average Exercise Price (CAD $)*
$6.13–$6.90	2,124,000	7.2 years	$ 6.55	810,200	$ 6.35
$7.95–$8.60	2,529,000	7.7 years	8.28	734,160	8.54
$9.20–$10.00	418,950	4.3 years	9.24	408,150	9.23
	5,071,950	7.2 years	$ 7.63	1,952,510	$ 7.77

NOTE 8. earnings per common share

Earnings per common share is calculated as follows:

		2002		2001
EARNINGS AVAILABLE TO COMMON SHAREHOLDERS				
Earnings	$	13	$	12
Less: preferred share dividends		(2)		(2)
Earnings available to common shareholders	$	11	$	10
COMMON SHARES *(millions)*				
Weighted average number of common shares outstanding	$	142.1	$	140.2
Stock options		0.4		0.2
Diluted number of common shares	$	142.5	$	140.4
EARNINGS PER COMMON SHARE				
Basic	$	0.08	$	0.07
Diluted	$	0.08	$	0.07

The common shares pledged under the Company's executive share purchase plan are deducted from the weighted average number of common shares outstanding. Stock options issued under the Company's stock option plan (note 7) were included in the calculation of diluted number of common shares to the extent the exercise price of those options was less than the average market price of the Company's common shares.

NOTE 9. income taxes

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts used for income tax purposes.

Significant components of the provision for (recovery of) income taxes are as follows:

		2002		2001
Current tax expense	$	6	$	5
Future income tax recovery		(22)		(22)
Income tax recovery	$	(16)	$	(17)

The differences between income taxes computed using statutory tax rates and income tax recovery as recorded are as follows:

		2002		2001
Loss before income tax recovery	$	(3)	$	(5)
Tax recovery at combined statutory rates		(1)		(2)
Effect of:				
Rate differences on foreign activities		(19)		(17)
Rate differences on manufacturing activities		1		1
Non-taxable income and expenses		–		(2)
Large corporations tax and other		3		3
Income tax recovery	$	(16)	$	(17)

The income tax effects of temporary differences that give rise to future income taxes are as follows:

	2002	2001
Benefit of tax loss-carryforwards	$ 128	$ 80
Investment tax credits	20	17
Alternative minimum taxes paid	5	8
Post-employment benefits	15	20
Other future income tax assets	24	24
Property, plant and equipment	(184)	(158)
Future income taxes, net	$ 8	$ (9)
Represented by:		
Current future income tax asset	$ 13	$ 15
Long-term future income tax asset	7	–
Long-term future income tax liability	(12)	(24)
	$ 8	$ (9)

Income and income-related taxes of nil (2001 – $8) were paid during the year.

NOTE 10. change in non-cash working capital

The net change in non-cash working capital balances comprises:

	2002	2001
Cash provided by (used for):		
Accounts receivable	$ (10)	$ 3
Inventory	(7)	32
Accounts payable and accrued liabilities	49	(6)
	$ 32	$ 29

Changes in bank advances and current portion of long-term debt are included in other debt repaid, net.

NOTE 11. investment and acquisitions

In April 2002, Nexfor purchased two oriented strand board mills in Texas and one in Georgia for $250. The allocation of the purchase price is as follows:

Working capital	$ 8
Property, plant and equipment	242
	$ 250

In May 2002, Nexfor purchased a pulp mill, a paper mill and a landfill facility in New Hampshire for a nominal amount. Subsequent to the acquisition, Nexfor sold the landfill facility for proceeds of $10 and signed an agreement whereby the New Hampshire paper and pulp mills will utilize the facility to dispose of its waste. A pre-tax gain of $3 has been recorded in earnings. The balance of the gain of $7 has been deferred and will be amortized over the minimum term of the waste disposal agreement.

NOTE 12. employee benefit plans

PENSION PLANS

Nexfor has a number of pension plans, participation in which is available to substantially all employees after periods of up to two years of continuous service. Hourly employees are generally members of negotiated plans. Nexfor's obligations under its defined benefit pension plans are determined periodically through the preparation of actuarial valuations. The measurement date for all defined benefit pension plans is September 30. Information about these plans is as follows:

	2002	2001
CHANGE IN ACCRUED BENEFIT OBLIGATION DURING THE YEAR:		
Accrued benefit obligation, beginning of year	$ 379	$ 360
Employee contributions	2	3
Current service cost	9	8
Interest on accrued benefit obligation	26	25
Benefits paid	(26)	(36)
Net actuarial loss	19	13
Curtailment gain	–	(2)
Foreign currency exchange rate impact	(4)	8
Accrued benefit obligation, end of year (1)	$ 405	$ 379
CHANGE IN PLAN ASSETS DURING THE YEAR:		
Plan assets, beginning of year	$ 316	$ 375
Actual return on plan assets	(20)	(43)
Employer contributions	10	12
Employee contributions	2	3
Benefits paid	(26)	(36)
Foreign currency exchange rate impact	(2)	5
Plan assets, end of year (1)	$ 280	$ 316
RECONCILIATION OF FUNDED STATUS:		
Accrued benefit obligation	$ 405	$ 379
Plan assets	280	316
Accrued benefit obligation in excess of plan assets	(125)	(63)
Unamortized net actuarial loss	124	61
Unamortized prior service costs	7	8
Unamortized net transitional asset	(15)	(17)
Post-measurement date contributions	4	1
Net accrued benefit liability	$ (5)	$ (10)

(1) Includes accrued benefit obligations of $405 (2001 – $362) and plan assets of $280 (2001 – $297) related to defined benefit pension plans with accrued benefit obligations in excess of plan assets.

	2002	2001
COMPONENTS IN NET PENSION EXPENSE:		
Current service cost	$ 9	$ 8
Interest on accrued benefit obligation	26	25
Expected return on plan assets	(27)	(29)
Amortization of transitional asset	(1)	(1)
Amortization of prior service costs	1	1
Amortization of net actuarial (gain) loss	1	(1)
Curtailment gain	–	(2)
Net periodic pension expense	$ 9	$ 1
SIGNIFICANT ACTUARIAL ASSUMPTIONS:		
Discount rate	6.50%–6.75%	6.75%–7.25%
Expected long-term rate of return on plan assets	8.00%	8.00%
Rate of compensation increase	3.75%–4.00%	3.75%–4.50%

Operating costs include $7 (2001 – $6) related to contributions to Nexfor's defined contribution pension plans.

POST-RETIREMENT BENEFIT PLANS

Nexfor funds health care benefits costs on a pay-as-you-go basis. Nexfor's obligations under its post-retirement benefit plans are determined periodically through actuarial valuations. The measurement date for all post-retirement benefit plans is September 30. Information about these plans is as follows:

	2002	2001
CHANGE IN ACCRUED BENEFIT OBLIGATION DURING THE YEAR:		
Accrued benefit obligation, beginning of year	$ 38	$ 29
Current service cost	1	1
Interest on accrued benefit obligation	2	3
Benefits paid	(2)	(1)
Net actuarial loss	13	4
Curtailment loss	–	1
Foreign currency exchange rate impact	(5)	1
Accrued benefit obligation, end of year	$ 47	$ 38
RECONCILIATION OF FUNDED STATUS:		
Accrued benefit obligation	$ 47	$ 38
Plan assets	–	–
Accrued benefit obligation in excess of plan assets	(47)	(38)
Unamortized net actuarial loss	9	1
Post-measurement date contributions	1	1
Net accrued benefit liability	$ (37)	$ (36)

	2002	2001
COMPONENTS OF NET POST-RETIREMENT BENEFIT EXPENSE:		
Current service cost	$ 1	$ 1
Interest on accrued benefit obligation	2	3
Net periodic post-retirement benefit expense	$ 3	$ 4
SIGNIFICANT ACTUARIAL ASSUMPTIONS:		
Discount rate	6.50%–6.75%	6.75%–7.25%
Health care cost trend rate – 2002	10.00%–10.25%	7.30%–8.00%
Health care cost trend rate – 2012 (ultimate)	5.00%–5.25%	4.50%–5.50%

POST-EMPLOYMENT BENEFITS

The Company paid $3 (2001 – $10) of severance related payments.

NOTE 13. commitments & contingencies

COUNTERVAILING DUTY AND ANTIDUMPING DUTY

Through 2001 and early 2002 the US Department of Commerce (DOC) and the US International Trade Commission (ITC) made various determinations under petitions to impose antidumping duties (ADD) and countervailing duties (CVD) on softwood lumber exported from Canada to the United States.

On May 16, 2002, the ITC ruled on the CVD and ADD announced by the DOC on March 22, 2002. The impact of the ITC ruling is that the CVD of 18.8% and ADD of 8.4% apply to shipments of lumber to the US after May 22, 2002. From May 22, 2002, onward, Nexfor's Quebec mills will be subject to both the CVD and ADD, while the New Brunswick mills will only be subject to ADD.

The table below summarizes the duties paid or accrued through December 31, 2002:

Duties charged to earnings to December 31, 2001	$ 3
Duties charged to earnings during 2002	8
Duties paid during 2002	(6)
Duties reversed in the second quarter of 2002	(5)
Duties accrued to December 31, 2002	$ –

Nexfor and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with determinations made by the ITC and DOC. Canadian Interests continue to aggressively defend the Canadian industry in this trade dispute. Canadian Interests have appealed the decisions of these administrative agencies to appropriate courts, North American Free Trade Agreement (NAFTA) panels and the World Trade Organization (WTO). Notwithstanding the rates established by the rulings, the final liability for the assessment of CVDs and ADDs will not be determined until the administrative review process is complete.

The final amount and the effective date of CVDs and ADDs that may be assessed on Canadian softwood lumber exports to the US cannot be determined at this time and will depend on determinations yet to be made by any reviewing courts, NAFTA or WTO panels.

FORWARD FOREIGN EXCHANGE CONTRACTS

The Company has entered into forward foreign exchange contracts of £165 (2001 – £183), which are designated as a hedge against its net investments in the United Kingdom. In addition, the Company has entered into forward foreign exchange contracts of CAD $12, which are designated as a hedge against its net Canadian dollar-denominated monetary assets. In 2001, the Company had entered into forward foreign exchange contracts of US $241 that were designated as a hedge against its net investment in the United States.

The Company has entered into forward foreign exchange contracts of CAD $108, which are designated as a hedge of future Canadian dollar-denominated net costs. These agreements mature at various dates to October 15, 2003, at an average exchange rate of CAD $1.00 = US $0.6372.

ENVIRONMENT

During 2002, certain environmental tests were conducted on land associated with a mill site previously shut down by Nexfor. These tests indicated the presence of contaminated soil on the site. Site remediation requirements and any costs thereon are not determinable at this time. However, Nexfor believes that any remediation costs for the site will ultimately be recoverable from the previous owners of the mill.

OTHER

Nexfor has entered into various commitments for capital expenditures and the future supply of operating services and materials.

NOTE 14. related party transactions

Nexfor purchases certain of its electricity from related parties. These parties are related by virtue of being under common significant influence. During 2002, Nexfor purchased $9 (2001 – $6) of electricity from these related parties. Included in accounts payable and accrued liabilities is $1 (2001 – nil) owing to these related parties.

In 2002, the Company paid $1 (2001 – nil) in fees related to a $100 subordinated stand-by loan facility arranged with a party related by virtue of being under common significant influence.

NOTE 15. significant differences in generally accepted accounting principles in Canada and the United States

These consolidated financial statements vary in certain respects from financial statements prepared in accordance with US GAAP. Application of US GAAP would have affected earnings and financial position as set out below:

	2002	2001
ADJUSTED BALANCE SHEET ACCOUNTS		
Current assets, excluding future income taxes	$ 430	$ 489
Property, plant and equipment	1,425	1,231
Other assets	67	13
Future income taxes, net	48	12
Current liabilities	418	206
Long-term debt	659	676
Other liabilities	167	100
Shareholders' equity	726	763

	2002	2001
ADJUSTMENTS TO EARNINGS		
Earnings in the consolidated statements of earnings	$ 13	$ 12
Unrealized gain on foreign exchange contracts (1)	–	1
Provision for Paper and Pulp operations (2)	1	1
Capitalized start-up costs (3)	(7)	(4)
Income taxes relating to above adjustments	2	1
Earnings in accordance with US GAAP	9	11
Change in foreign currency translation adjustment	7	(43)
Unrealized loss on temporary investments	(1)	(1)
Minimum pension liability adjustment (5)	(52)	(26)
Unrealized gain (loss) on foreign exchange contracts (1)	5	(8)
Income taxes on comprehensive income items	18	10
Comprehensive loss in accordance with US GAAP (4)	$ (14)	$ (57)
Earnings per common share (7) – Basic	$ 0.05	$ 0.06
– Diluted	$ 0.05	$ 0.06
ADJUSTMENTS TO SHAREHOLDERS' EQUITY		
Shareholders' equity in the consolidated balance sheets	$ 800	$ 814
Adjustments affecting opening shareholders' equity		
Recognition of unrealized gain on foreign exchange contracts	2	1
Provision for Paper and Pulp operations	(15)	(16)
Capitalized start-up costs	(14)	(10)
Future income tax on adjustments	10	9
Impact of change in reporting currency (6)	–	(13)
Adjustment to earnings	(4)	(1)
Cumulative comprehensive income related to gains on temporary investments	–	1
Cumulative comprehensive loss related to minimum pension liability	(52)	(17)
Cumulative comprehensive loss related to foreign exchange contracts	(1)	(5)
	$ 726	$ 763

(1) Under US GAAP, forward foreign exchange contracts that serve as an economic hedge of future foreign currency-denominated transactions must be carried at fair value with the unrealized gains or losses for the period included in the determination of comprehensive income. Prior to the change in US GAAP in accounting for derivative instruments and hedging activities that became effective January 2001, these unrealized gains or losses were recognized in income for US GAAP purposes.

(2) Under US GAAP, the estimated future cash flows used to determine the recoverability of the paper and pulp assets must exclude carrying charges. In addition, the provision against these operations was determined by discounting the cash flows and comparing to the carrying costs of those assets.

(3) Under US GAAP, costs incurred net of revenues earned during the start-up of a new production facility must be charged to income in the year incurred.

(4) Under US GAAP, certain direct credits or charges to shareholders' equity must be included in the determination of comprehensive income.

(5) Under US GAAP, an additional minimum pension liability must be recognized when an unfunded accumulated benefit obligation exists.

(6) Under US GAAP, a change in reporting currency requires the retroactive restatement of the financial statements using historical exchange rates.

(7) Earnings per common share under US GAAP is calculated based on earnings in accordance with US GAAP.

NOTE 16. segmented information

Nexfor operates principally in Canada, the United States and the United Kingdom, and is divided into three main operating segments: North American Building Materials, European Panels, and Paper and Pulp.

A. OPERATING SEGMENTS

	North American Building Materials	*European Panels*	*Paper and Pulp*	*Consolidated Total*
2002				
Net sales	$ 654	$ 227	$ 600	$ 1,481
Operating earnings (loss)	46	(2)	(16)	28
Assets				
Segmented	860	314	650	1,824
Non-segmented and corporate assets				78
Cash and short-term notes				67
Total assets				$ 1,969
Depreciation	$ 58	$ 23	$ 40	$ 121
Capital investments	$ 14	$ 8	$ 22	$ 44

	North American Building Materials	*European Panels*	*Paper and Pulp*	*Consolidated Total*
2001				
Net sales	$ 475	$ 208	$ 635	$ 1,318
Operating earnings (loss)	35	(20)	7	22
Assets				
Segmented	672	304	641	1,617
Non-segmented and corporate assets				62
Cash and short-term notes				116
Total assets				$ 1,795
Depreciation	$ 35	$ 20	$ 40	$ 95
Capital investments	$ 46	$ 23	$ 31	$ 100

B. GEOGRAPHIC SEGMENTS

Net sales by geographic segment are determined based on the country of shipment.

	Net Sales		*Property, Plant and Equipment*	
	2002	2001	2002	2001
United States	$ 860	$ 725	$ 859	$ 665
Canada [1]	394	385	345	370
United Kingdom	227	208	235	231
Consolidated total	$ 1,481	$ 1,318	$ 1,439	$ 1,266

[1] Export sales included in total	$ 238	$ 246

NOTE 17. comparative figures

Certain 2001 figures have been reclassified to conform to current year's presentation.

SELECTED quarterly information

(in US $ millions, except per share information)	2002 *1st*	*2nd*	*3rd*	*4th*	*Total*
EARNINGS					
Net sales	$ 338	$ 385	$ 374	$ 384	$ 1,481
Operating costs:					
Cost of sales	291	321	317	342	1,271
Depreciation	27	31	32	31	121
Selling, general and administrative	15	15	16	15	61
	333	367	365	388	1,453
Operating earnings (loss)	5	18	9	(4)	28
Interest and other income	1	2	1	2	6
Interest expense	(7)	(9)	(11)	(10)	(37)
Income tax recovery	4	1	5	6	16
Earnings (loss)	$ 3	$ 12	$ 4	$ (6)	$ 13
Earnings (loss) per common share					
– Basic	$ 0.01	$ 0.08	$ 0.02	$ (0.03)	$ 0.08
– Diluted	$ 0.01	$ 0.08	$ 0.02	$ (0.03)	$ 0.08
Common dividend per share	$ 0.06	$ 0.07	$ 0.06	$ 0.07	$ 0.26
NET SALES					
North American Building Materials	$ 136	$ 188	$ 169	$ 161	$ 654
European Panels	55	54	57	61	227
Paper and Pulp	147	143	148	162	600
Total net sales	$ 338	$ 385	$ 374	$ 384	$ 1,481
OPERATING EARNINGS					
North American Building Materials	$ 12	$ 24	$ 8	$ 2	$ 46
European Panels	(4)	–	1	1	(2)
Paper and Pulp	(3)	(6)	–	(7)	(16)
Total operating earnings (loss)	$ 5	$ 18	$ 9	$ (4)	$ 28

(in US $ millions, except per share information)	*1st*	*2nd*	*2001* *3rd*	*4th*	*Total*
EARNINGS					
Net sales	$ 329	$ 337	$ 330	$ 322	$ 1,318
Operating costs:					
Cost of sales	296	284	280	284	1,144
Depreciation	23	22	25	25	95
Selling, general and administrative	14	15	14	14	57
	333	321	319	323	1,296
Operating earnings (loss)	(4)	16	11	(1)	22
Interest and other income	2	1	1	2	6
Interest expense	(9)	(8)	(8)	(8)	(33)
Income tax recovery	8	–	2	7	17
Earnings (loss)	$ (3)	$ 9	$ 6	$ –	$ 12
Earnings (loss) per common share					
– Basic	$ (0.03)	$ 0.06	$ 0.04	$ –	$ 0.07
– Diluted	$ (0.03)	$ 0.06	$ 0.04	$ –	$ 0.07
Common dividend per share	$ 0.07	$ 0.06	$ 0.07	$ 0.06	$ 0.26
NET SALES					
North American Building Materials	$ 100	$ 129	$ 133	$ 113	$ 475
European Panels	55	51	50	52	208
Paper and Pulp	174	157	147	157	635
Total net sales	$ 329	$ 337	$ 330	$ 322	$ 1,318
OPERATING EARNINGS					
North American Building Materials	$ (3)	$ 22	$ 16	$ –	$ 35
European Panels	(5)	(3)	(7)	(5)	(20)
Paper and Pulp	4	(3)	2	4	7
Total operating earnings (loss)	$ (4)	$ 16	$ 11	$ (1)	$ 22

SIX-YEAR historical review

(in US $ millions, except per share information)	2002	2001
EARNINGS		
Net sales	$ 1,481	$ 1,318
Operating costs:		
Cost of sales	1,271	1,144
Depreciation	121	95
Selling, general and administrative	61	57
	1,453	1,296
	28	22
Reorganization costs	–	–
Operating earnings (before Paper and Pulp provision)	28	22
Provision for Paper and Pulp operations	–	–
Gain on sale of operations and other income	6	6
Interest expense	(37)	(33)
Income tax recovery (expense)	16	17
Earnings	$ 13	$ 12
BALANCE SHEET		
Current assets	$ 443	$ 511
Property, plant and equipment	1,439	1,266
Other assets	87	18
Total assets	$ 1,969	$ 1,795
Current liabilities	$ 418	$ 209
Long-term debt	659	687
Other liabilities	80	61
Future income taxes	12	24
Shareholders' equity	800	814
Total liabilities and shareholders' equity	$ 1,969	$ 1,795
CASH FLOW		
Cash flow from operations	$ 146	$ 106
Additions to property, plant and equipment	(44)	(100)
Investments, net	(288)	(38)
Dividends	(22)	(34)
Debt incurred (repaid)	135	66
Issue (repurchase) of shares	–	–
Other	24	10
Increase (decrease) in cash and short-term notes	$ (49)	$ 10
PER COMMON SHARE		
Earnings – Basic	$ 0.08	$ 0.07
– Diluted	0.08	0.07
Book value	5.30	5.50
Dividends	0.26	0.26
Market price range *(CAD $)*		
High	9.70	8.45
Low	7.13	6.30
Close	8.25	7.50

Note: Certain figures have been reclassified to conform to the current year's presentation.

In 1999, Nexfor began accounting for its non-pension retirement benefits on an accrual basis. The unrecorded projected benefit obligation of $25 million ($15 million net of tax) has been charged to opening retained earnings in 1998.

2000	1999	1998	1997
$ 1,362	$ 1,503	$ 1,508	$ 1,410
1,099	1,155	1,229	1,151
92	103	107	99
57	70	74	78
1,248	1,328	1,410	1,328
114	175	98	82
–	–	–	(20)
114	175	98	62
–	(155)	–	–
27	216	1	5
(25)	(34)	(42)	(37)
(22)	(32)	(27)	(18)
$ 94	$ 170	$ 30	$ 12
$ 536	$ 539	$ 511	$ 440
1,214	1,070	1,241	1,252
14	20	19	7
$ 1,764	$ 1,629	$ 1,771	$ 1,699
$ 212	$ 230	$ 385	$ 268
588	379	475	528
62	59	70	37
71	46	39	24
831	915	802	842
$ 1,764	$ 1,629	$ 1,771	$ 1,699
$ 134	$ 246	$ 192	$ 73
(173)	(164)	(141)	(115)
45	124	75	(8)
(43)	(47)	(48)	(47)
198	(163)	15	(13)
(143)	(10)	(4)	(9)
–	–	8	–
$ 18	$ (14)	$ 97	$ (119)
$ 0.61	$ 1.07	$ 0.14	$ 0.04
0.61	1.07	0.14	0.04
5.65	5.24	4.42	4.65
0.26	0.26	0.26	0.26
9.25	10.15	10.20	10.50
5.85	5.70	5.80	7.25
7.10	8.40	6.05	7.75

PRINCIPAL operating interests

	Annual Capacity at Year-End 2002	*Production* 2002	2001
North American Building Materials			
LUMBER *(MMfbm)*			
Ashland, Maine	60	74	55
Juniper, New Brunswick	160	133	130
La Sarre, Quebec	120	112	108
Masardis, Maine	120	122	119
Plaster Rock, New Brunswick	120	119	112
Senneterre, Quebec	140	136	140
	720	696	664
OSB *(MMsf-3/8")*			
Bemidji, Minnesota (1)	1,320	1,268	1,221
Cordele, Georgia (2)	2,250	1,652	–
Guntown, Mississippi	2,600	2,113	2,201
Huguley, Alabama	3,000	2,375	460
Jefferson, Texas (2)	2,310	1,519	–
Joanna, South Carolina	3,000	2,029	1,460
La Sarre, Quebec	2,100	1,978	1,927
Nacogdoches, Texas (2)	1,620	1,303	–
Val-d'Or, Quebec	1,800	1,816	1,785
	20,000	16,053	9,054
MDF *(MMsf-3/4")*			
Deposit, New York	950	930	936
PLYWOOD *(MMsf-3/8")*			
Cochrane, Ontario	490	474	478
I-JOIST *(MM lineal feet)*			
Juniper, New Brunswick	80	31	26

	Annual Capacity at Year-End 2002	Production 2002	2001
European Panels			
OSB *(MMsf–3/8")*			
Inverness, Scotland	2,100	1,867	1,745
MDF *(MMsf–3/8")*			
Cowie, Scotland	2,450	2,216	2,190
PARTICLEBOARD *(MMsf–3/8")*			
Cowie, Scotland	1,950	1,681	1,778
South Molton, England	1,800	1,682	1,611
	3,750	3,363	3,389
Paper and Pulp			
WOODFREE PAPER *(000 tonnes)*			
Gorham, New Hampshire (3)	145	41	–
Madawaska, Maine	240	229	224
Park Falls, Wisconsin	120	110	113
West Carrollton, Ohio (4)	–	–	15
	505	380	352
GROUNDWOOD PAPER *(000 tonnes)*			
Madawaska, Maine	175	178	186
PAPERBOARD *(000 tonnes)*			
Edmundston, New Brunswick	50	51	51
TOWEL *(000 tonnes)*			
Gorham, New Hampshire	36	18	–
PULP *(000 tonnes)*			
Berlin, New Hampshire (5)	240	–	–
Thurso, Quebec	245	237	224
	485	237	224

(1) Owned 50%. Capacity and production represent 50% ownership.
(2) Acquired April 2002.
(3) Acquired May 2002.
(4) Closed permanently March 2001.
(5) Acquired May 2002. Scheduled to commence operations in 2003.

Report on Environment, Health and Safety

NEXFOR

ENVIRONMENTAL policy

Nexfor Inc. recognizes that our environment is fundamental to our existence, and that our businesses and the communities where we operate depend upon its health. We strive for excellence, leadership, sustainability and competitive advantage, with integrity, through continual improvement in our environmental performance and management of forest land. For Nexfor, sustainable development means creating economic growth while caring for society and the environment.

Nexfor and its operations will integrate environmental protection into their business processes and decisions. Our belief in sustainable development means we are committed to:

FULL COMPLIANCE
Comply fully with all applicable environmental legislation and regulations that affect our activities.

FOREST MANAGEMENT
Manage forests in a manner consistent with the principles of sustainable forestry, this policy and applicable legislation.

MINIMIZATION OF ENVIRONMENTAL IMPACT
Improve our environmental performance as the expectations of society change. We shall do this by using forest, energy and other resources with increasing efficiency, and by reducing all forms of waste.

RISK MANAGEMENT
Continually identify, evaluate and control the environmental risks associated with our operations. We shall have procedures in place to prevent and respond to emergencies.

ENVIRONMENTAL MANAGEMENT SYSTEMS
Implement systematic environmental management that supports this policy at every operation. We shall assign appropriate human and financial resources. Every year we shall establish measurable objectives and targets for environmental management and performance improvement.

INNOVATION
Support pollution prevention and environmental research, and implement findings consistent with this policy.

PERFORMANCE EVALUATION
Evaluate the environmental performance of our operations and personnel, and recognize achievements that support this policy. We shall provide our employees with information and training for them to fully integrate this policy into their responsibilities at work.

COMMUNICATIONS WITH STAKEHOLDERS
Engage in a constructive dialogue with the communities in which we operate and other key stakeholders, taking their needs into account when we make our decisions.

OPEN GOVERNMENT RELATIONSHIPS
Work constructively with governments and regulators on the establishment of scientifically and economically sound requirements for our operations.

AUDITS
Conduct environmental audits at all our operations at a frequency appropriate to their risks.

REPORTS
Report regularly on our environmental performance to the management of the Company, the Board of Directors, our shareholders, employees and the communities in which we operate.

Nexfor Inc. requires its operations to develop policies, systems, organizations and competencies, and to embrace an environmental commitment consistent with these principles. Nexfor requires all employees to take responsibility for environmental protection in their jobs.

Dominic Gammiero

DOMINIC GAMMIERO
President & Chief Executive Officer

HEALTH and safety policy

We are committed to safeguarding the health and well-being of our employees, contractors and visitors by creating and maintaining a safe working environment.

BELIEFS

- All injuries and occupational illnesses are preventable.
- Health and safety is a top priority and an integral part of our business and decision-making.
- Management is ultimately responsible for workplace health and safety.
- Safe operating practices are a shared responsibility among management, employees, contractors and visitors.
- Employees and contractors are accountable for their safety and that of fellow workers.
- Working safely is a condition of employment.
- Sharing best practices improves performance.

PRACTICES

- Design safe facilities.
- Continually review and improve processes and procedures.
- Identify hazards and assess risks.
- Develop, implement and enforce safe work practices.
- Ensure all facilities comply with applicable laws and regulations.
- Provide employees with information and training to work safely.
- Require employees and contractors to execute their work in accordance with legislative requirements and Nexfor policy.
- Establish and monitor health and safety objectives.
- Take action to prevent recurrence of incidents.
- Implement health and safety management systems to continually improve performance.
- Conduct health and safety audits.
- Report health and safety performance to senior management, the Board of Directors, shareholders, employees, and the public.

DOMINIC GAMMIERO
President & Chief Executive Officer

2002 REPORT ON ENVIRONMENT, HEALTH and SAFETY

Our commitment at Nexfor is to protect the health and safety of our employees and continuously advance our environmental performance. This year, we increased our efforts to create a safe working environment for employees, contractors and visitors to our mills. Our environmental compliance was excellent. Across many of our operations, particularly in the United States, we are assessing and installing new technologies to meet increasingly stringent environmental standards.

HEALTH AND SAFETY

Overall, Nexfor's safety performance continues to improve. Effective 2002, the Occupational Safety and Health Administration (OSHA) revised their reporting standards, which changed the way we measure lost-time incidents and define medical treatments. This change in reporting standards makes it difficult to compare 2002 performance to the prior year as they are no longer based on the same criteria. If 2001 criteria were used to measure 2002 performance, Nexfor's OSHA rate would show a six percent improvement. We expect to provide a more comprehensive year-over-year comparison in next year's report.

Nexfor's goal is to prevent incidents from happening in our mills. Those that occur, we investigate thoroughly to understand the cause and prevent similar incidents from happening again. Based on these efforts, the European Panels operation achieved a 2002 OSHA recordable rate of 1.95, our Paper and Pulp business unit recorded an OSHA recordable rate of 3.34, and our North American Building Materials operations recorded an OSHA recordable rate of 5.09. As a whole, Nexfor's OSHA recordable rate for the year was 3.87.

In Europe, the South Molton, England, operation, which implemented an internationally recognized behavioural safety program, led the improvement with a major reduction to 1.49.

Our Paper and Pulp operations heightened their commitment during the year with improved management audits and by applying the DuPont Safety Training Observation Program (STOP) at all mills and woodland operations. The Edmundston, New Brunswick, mill achieved an OSHA recordable rate of 1.96; the lowest across all paper and pulp operations.

While the performance of our North American Building Materials operations was consistent with historical industry averages, it did fall below expectations. To address this decline in safety performance, our North American Building Materials business introduced the "100% Compliance" initiative. Launched in June 2002, it is essentially a zero-tolerance program that focuses on safety violations in the four areas most likely to result in a serious injury or fatality: lock-out, fall protection, mobile equipment operation and confined space entry. While the business unit overall did not meet our target, the OSB mill at Nacogdoches, Texas, achieved a stellar safety performance with an OSHA recordable rate of 0.67.

CONTRACTOR SAFETY

Nexfor is implementing a common set of environment, health and safety guidelines for contractors at all operations. The guidelines clearly outline consistent expectations for contractors by defining environment, health and safety performance requirements, roles, necessary training and responsibilities. We expect implementation to be complete across all operations in 2003 and will schedule audits to measure their effectiveness.

KYOTO ACCORD

Nexfor supports a Canadian climate-change process to reduce greenhouse gas emissions. However, we believe the process should be equitable across all industries. We also believe that forest product companies should receive credit for emission reductions achieved since 1990.

Considering our continuous efforts to reduce greenhouse gas emissions, we do not anticipate any capital investments will be necessary in 2003 for Nexfor to comply with the recommendation of a six percent reduction in greenhouse gas emissions by 2012.

In the UK, our operations already comply with the climate-change process introduced by the government in 2000. The UK ratified the Kyoto Accord in 2002.

AIR QUALITY IMPROVEMENTS

In May, Nexfor acquired a paper and pulp facility in New Hampshire. At that time, the operations did not meet the US Environmental Protection Agency (EPA) Cluster Rule air emission limits. To comply with the requirements, we are working with Brascan Power to install a $33 million package boiler and cogeneration facility, which should be complete by December 2003.

We received a notice of violation at our Joanna, South Carolina, OSB mill in 2002 relating to non-compliance with permitting regulations for volatile organic compound (VOC) emissions from the mill. We do not expect the resulting penalty from the state to be material. To rectify the situation, we have implemented a number of process modifications and have been working with the state to adjust our operating permit criteria.

In Canada, our North American Building Materials operations and our Thurso, Quebec, pulp mill are working with Paprican and Environment Canada to develop test methods for emissions of particulates less than 2.5 microns in size. Their work in our mills will help define realistic requirements for future emission regulations.

MAXIMUM ACHIEVABLE CONTROL TECHNOLOGY REGULATIONS

The US EPA is in the process of developing and receiving federal approval on Maximum Achievable Control Technology (MACT) regulations to control 188 hazardous air pollutants. The regulations will apply only to "major sources" of pollutants – those facilities that emit 10 tons of any one hazardous air pollutant per year or more than 25 tons of combined pollutants from the list. These new regulations will affect our MDF and OSB operations in the US where small amounts of formaldehyde, acetaldehyde and methanol are included in these mills' emissions to air. The MACT regulations for boilers will also affect our Park Falls, Wisconsin, paper mill for particulate matter, hydrochloric acid and mercury. A final ruling on the EPA proposals is expected in February 2004.

After the ruling, mills will have three years to comply. Early work is being done on a mill-by-mill basis to evaluate the impact on Nexfor. In some cases, we anticipate having to reduce our emissions of these pollutants by up to 90 percent through system modifications and additional emission control technology. We believe our mill in Joanna will meet the MACT requirements, and that our operations in Huguley, Alabama, and Jefferson, Texas, will be exempt. The following facilities will likely require varying degrees of modification to comply: Cordele, Georgia; Nacogdoches, Texas; Bemidji, Minnesota; Deposit, New York; Guntown, Mississippi; and Park Falls, Wisconsin.

EFFLUENT TREATMENT

The installation of a $14 million biological treatment plant was completed during 2002 at Nexfor's Madawaska, Maine, paper mill to meet federal and state toxicity limits on the mill's water discharge. The secondary effluent treatment system now uses suspended carrier biofilm to reduce toxic components previously discharged in the waste water. The new technology was chosen for its economic and ecological effectiveness.

The pulp facility in Thurso has reduced the amount of suspended solids in water going into its effluent treatment system by about 33 percent to 16.0 tonnes per day. The reduction did not require capital investment, as it was achieved through improved process controls and recycling. Annual savings from reduced sludge disposal are about $400,000.

ENERGY REDUCTION

All Nexfor sites in the UK have negotiated climate-change-related energy efficiency agreements with the government, committing them to a nine percent reduction in energy consumption by 2010. The resulting tax savings will be an additional £1.5 million in 2002. The Inverness mill in Scotland achieved a 25 percent energy reduction, which translated into operational savings of £250,000 for the year. Total energy-related savings across UK operations in 2002 are more than £1.3 million.

CERTIFICATION

Nexfor is a participant in the American Forest and Paper Association's Sustainable Forestry Initiative (SFI®) program. During 2002, the Plaster Rock, New Brunswick, sawmill and Levesque sawmills in Maine became the world's first manufacturers certified to stamp their lumber with the product labels of the SFI program.

Our other North American Building Materials mills continued their work toward SFI program certification of land management and wood procurement practices. Mills in Alabama, South Carolina, Georgia and Mississippi successfully completed final SFI program verification audits in December. We expect all operations to be fully certified by the end of the first quarter of 2003.

In the UK, all sites maintained their Forest Stewardship Council (FSC) chain of custody certification, which assures that products are made from sustainably managed resources.

RECYCLING

The reuse of post-consumer waste in particleboard at our UK operations continues to grow. Facilities at South Molton and our new £4 million waste recycling plant at Cowie, Scotland, recycled more than 243,000 tonnes in 2002. This resulted in cost savings of £500,000. The UK operations also earned "packaging waste recovery notes" by recycling a higher volume than required by the government. The sale of these notes to other companies generated more than £3.5 million during the year.

OPEN COMMUNICATIONS

Community forums at both Inverness and Cowie in Scotland continue to keep communication channels open with people living near our operations. At Inverness, candid discussion earned community acceptance of proposed permit changes relating to air emissions and formaldehyde emission limits. At Cowie, Nexfor continues to establish itself as a respected member of the community and has responded to the need of local law enforcement in the area by providing the funds to purchase a police car and refurbish a police station, including mobile and data communications tools for the village.

At Park Falls, a county-wide emergency drill was conducted in April 2002 involving all employees and local residents, businesses, schools and hospitals within a 100-mile radius. Police, fire and emergency response teams also actively participated in the mill's initiative.

The North American Building Materials division has committed to a wood procurement policy for purchasing wood from third parties. A copy of the policy can be found at www.norbord.com.

PHILANTHROPY

Nexfor's philanthropic goal is to enrich the quality of life in the communities where we operate, to conduct business based on respect, integrity and openness, and to encourage employee participation in non-profit endeavours in the community.

Nexfor increased its philanthropy in 2002 by 25 percent, by supporting educational, medical, social services and cultural activities. In particular, our North American Building Materials business increased its commitment to Habitat for Humanity, donating materials throughout the year to build homes for more than 30 families. We continue to sponsor the Nexfor Bowater Watershed Conservation Research Centre at University of New Brunswick, and support national organizations like United Way, Ducks Unlimited and the National Aboriginal Achievement Foundation. This year, Nexfor also awarded 24 undergraduate scholarships to children of our employees.

ENVIRONMENTAL report card

	2002 TARGET	2002 PERFORMANCE
1. Health and safety	20% reduction in injuries and illnesses measured by OSHA recordable rate	• 6% improvement in safety performance.
2. Full compliance	100% compliance with all applicable environmental legislation and regulations that affect our activities	• Achieved 99.21% compliance overall. • Achieved 98.24% compliance relating to air emissions at North American wood product operations.
3. Forest management	Complete SFI program certification on all managed woodlands in North America and maintain FSC certification on all UK woodlands	• SFI program certification of all North American wood procurement and woodland operations expected to be completed by the end of Q1, 2003. • All UK woodlands have retained FSC certification. • Sawmills in Plaster Rock, New Brunswick, and Levesque sawmills in Maine became first manufacturers in the world to stamp their lumber with the product labels of the SFI program.
4. Impact minimization	To reduce the environmental impact of our activities by reducing the amount of air emissions, effluents and waste generated from our operations and by maximizing material reuse and recycling	• Increased the amount of post-consumer waste used in particleboard manufacturing in UK operations. • Reduced energy usage 25% at OSB mill in Inverness, Scotland. • Installed $14 million effluent treatment plant at Madawaska, Maine. • Reduced amount of suspended solids in water by 33% at pulp facility in Thurso, Quebec. • 78% of all solid residues generated in the Park Falls, Wisconsin, facility are used as fertilizer on farmlands.
5. Audits	Implement risk-based Nexfor auditing system across all business units	• Nine audits have been conducted to-date, all of which were attended by a member of senior management. Nexfor's Executive Audit Program was implemented to reinforce management's commitment to the audit process.
6. Communications with stakeholders	Enhance our presence in the communities where we operate through increased dialogue, forums and involvement	• Community forums in UK foster open communication within local communities. • Emergency simulations done in Park Falls, Wisconsin; Thurso, Quebec; Edmundston, New Brunswick. • Wood procurement policy established by North American Building Materials business unit.

HEALTH and safety data

	North American Building Materials	*European Panels*	*Paper and Pulp*	*Total Nexfor*
Hours worked	6,048,000	2,048,000	6,476,000	14,572,000
Lost time accidents	46	15	34	95
Lost time frequency(1)	1.52	1.46	1.05	1.30
Days lost	2,249	216	1,807	4,272
OSHA recordable rate(1)	5.09	1.95	3.34	3.87

(1) per 200,000 hours worked

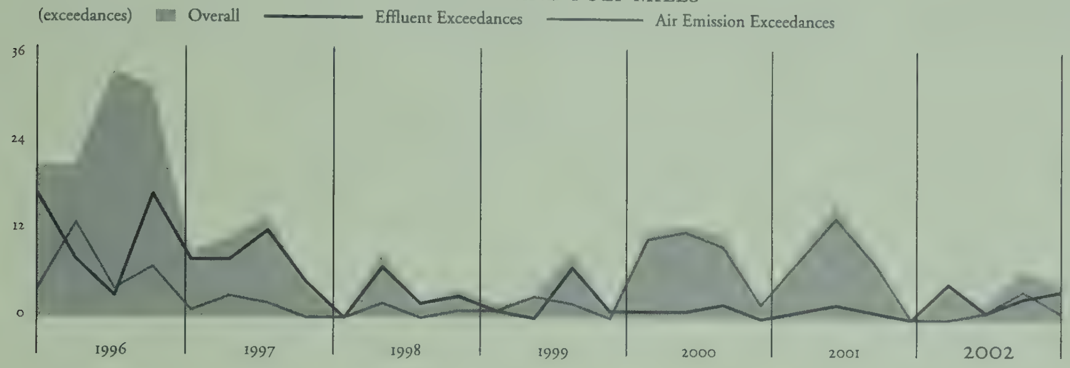
SOCIO-ECONOMIC data

Category of Expenditure ($ thousands, except for number of employees)	*North American Building Materials*	*European Panels*	*Paper and Pulp*	*Total Nexfor*
Number of employees	3,000	900	3,200	7,125(1)
Wages, salaries and benefits	$117,000	$36,000	$175,000	$331,000(1)
Municipal and school and other local taxes	5,000	2,000	7,000	14,000
Local purchases of goods and services	205,000	97,000	120,000	422,000
Logging contractor services (including fibre)	204,000	–	16,000	220,000
Wood chips and hog fuel purchases	12,000	39,000	42,000	93,000
Stumpage and royalty payments	16,000	–	1,000	17,000
Net sales generated	654,000	227,000	600,000	1,481,000
Total capital investments (including environmental)	14,000	8,000	22,000	44,000
Environmental capital investments	2,000	20	5,000	7,020
Environmental expenditures not capitalized	2,000	3,000	9,000	14,000
Total operating lease and rental payments	4,000	3,000	4,000	11,000
Total philanthropy	300	100	100	500

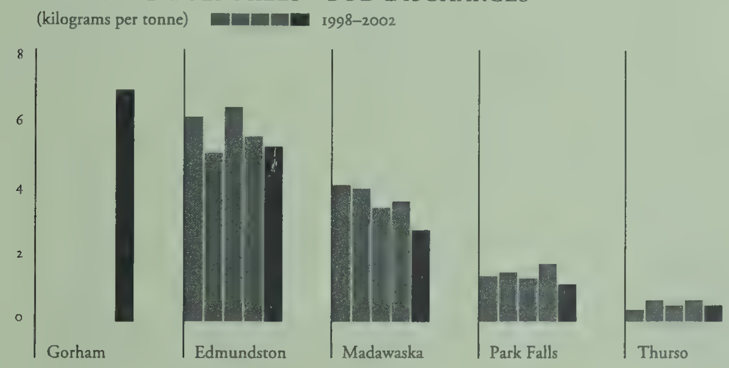
(1) Includes Nexfor Corporate.

HISTORICAL PERFORMANCE at a glance

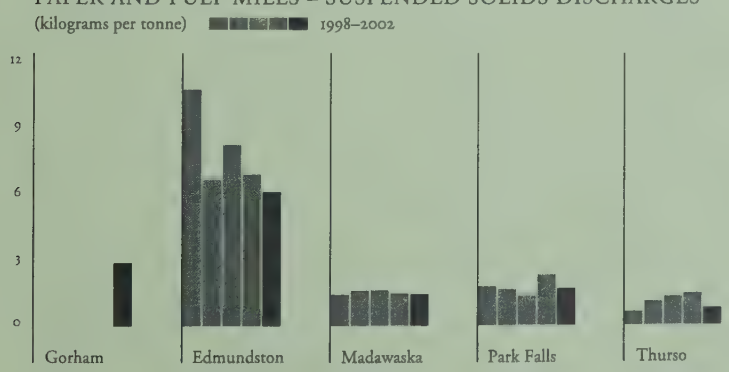
AIR AND WATER EXCEEDANCES AT PAPER AND PULP MILLS



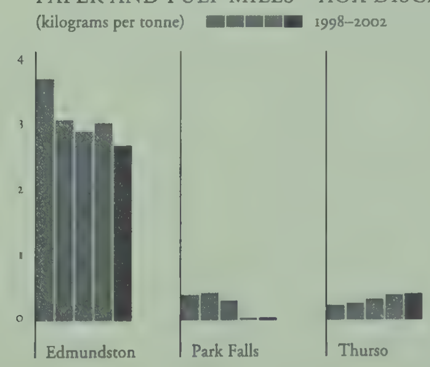
PAPER AND PULP MILLS – BOD DISCHARGES



PAPER AND PULP MILLS – SUSPENDED SOLIDS DISCHARGES

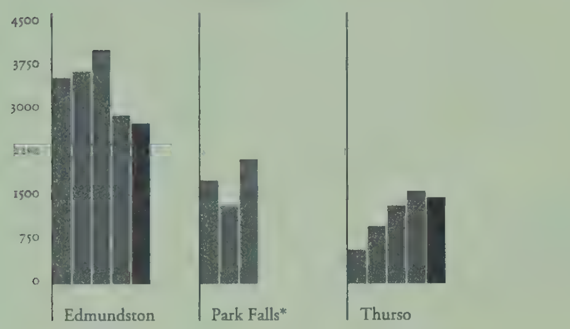


PAPER AND PULP MILLS – AOX DISCHARGES



PAPER AND PULP MILLS – CHLORINE GAS USE

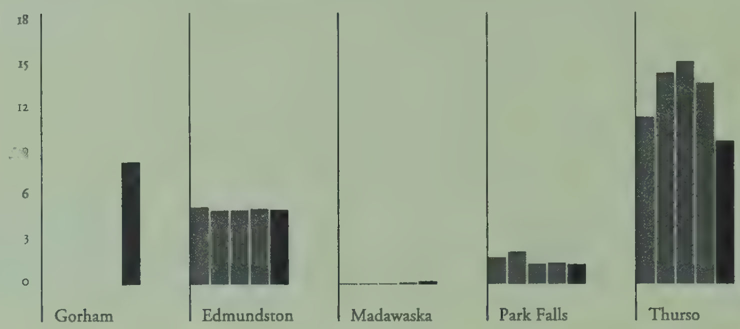
(tonnes per year) 1998–2002



* Park Falls: In late 2000 the mill installed peroxide bleaching thereby eliminating chlorine use.

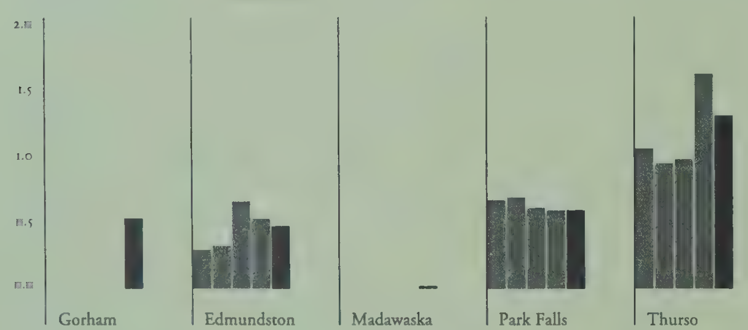
PAPER AND PULP MILLS – SULPHUR DIOXIDE EMISSIONS

(kilograms per tonne) 1998–2002



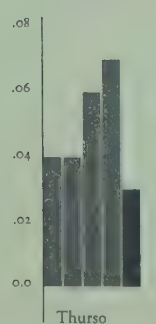
PAPER AND PULP MILLS – TOTAL SUSPENDED PARTICULATE EMISSIONS

(kilograms per tonne) 1998–2002



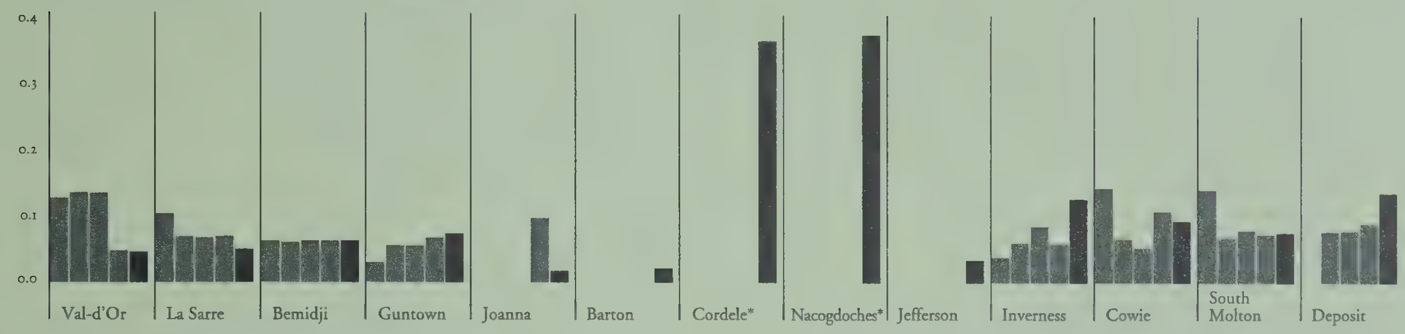
THURSO PULP MILL – TOTAL REDUCED SULPHUR EMISSIONS

(kilograms per tonne) 1998–2002



PANELBOARD MILLS – VOLATILE ORGANIC COMPOUND EMISSIONS

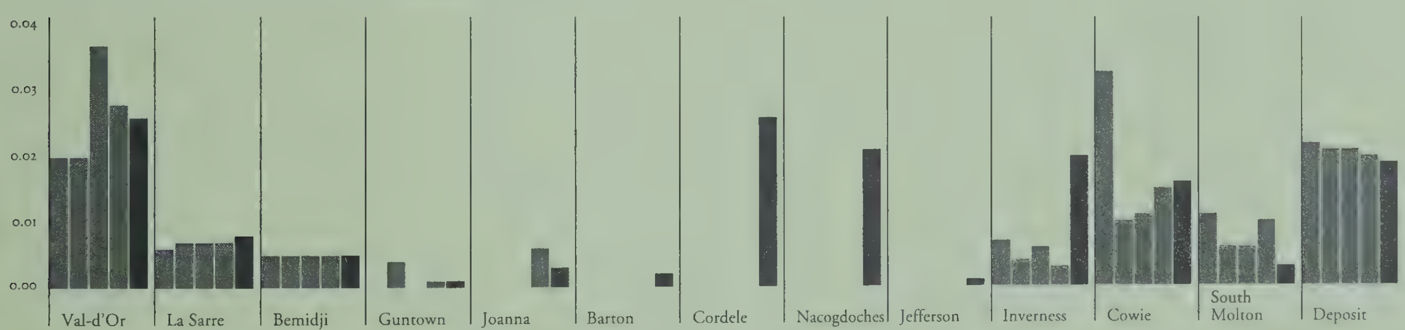
(kilograms per 1,000 square feet, 1/16" basis) 1998–2002



* Cordele – emissions are within permit limits. Higher than Nexfor average due to high temperature dryers and control technology. Expect reduction with implementation of MACT.
* Nacogdoches – emissions are within permit limits. Higher than Nexfor average due to high temperature dryers and control technology. Expect reduction with implementation of MACT.

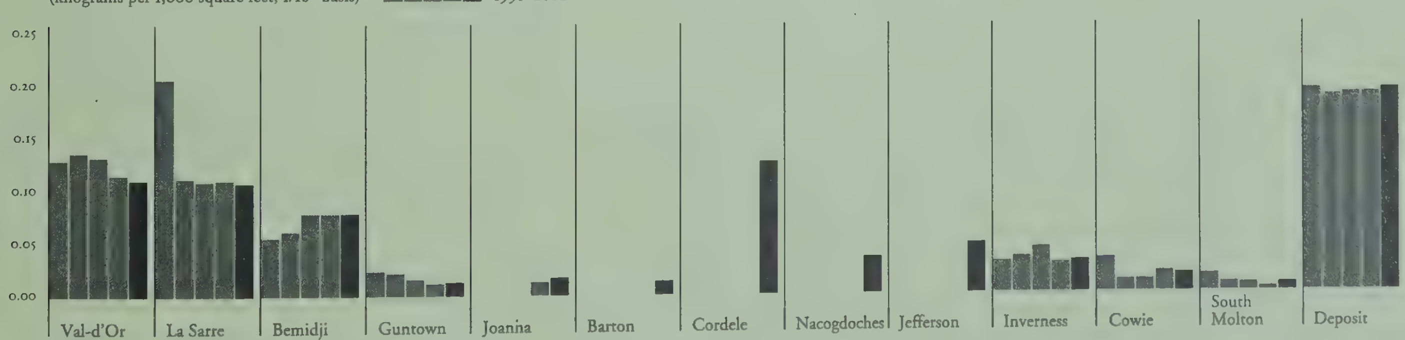
PANELBOARD MILLS – FORMALDEHYDE EMISSIONS

(kilograms per 1,000 square feet, 1/16" basis) 1998–2002



PANELBOARD MILLS – TOTAL SUSPENDED PARTICULATE

(kilograms per 1,000 square feet, 1/16" basis) 1998–2002



National Pollutant Release Inventory (NPRI) and Toxic Release Inventory (TRI) are toxic chemical release reporting programs in Canada and the United States, respectively. Reports are prepared according to a specific list of materials designated by each government and with a combination of measured emission data and emissions estimated from industry factors. Annual reports of emissions from operations in North America are submitted to federal governments in June and July. Therefore, our data is current to 2001. Data for 2002 will be reported in June and July 2003.

THE NATIONAL POLLUTANT RELEASE INVENTORY – CANADA
(in metric tonnes, unless otherwise noted)

		2000			2001		
Facility	*Material*	*Air*	*Water*	*Soil*	*Air*	*Water*	*Soil*
COCHRANE	Formaldehyde	4.90			4.90		
EDMUNDSTON	Acetaldehyde	19.23	1.43	0.08	18.77	1.22	0.04
	Ammonia	0.23	179.50		0.23	152.90	
	Chlorine	102.75			50.90		
	Chlorine dioxide	21.29			12.60		
	Chloroform	11.43	0.13		brt	brt	brt
	Dioxin/Furans *(milligrams)*	0.40		0.01	1.00		0.06
	Hydrochloric acid	10.10			10.10		
	Manganese	0.38	10.36	78.71	0.38	8.83	83.42
	Mercury *(kilograms)*	0.98	0.01	11.00	0.98	0.01	0.36
	Methanol	276.36	1.29	2.25	279.50	1.10	1.01
	Methyl ethyl keytone	10.97		7.20	10.90		3.24
	Sulphuric acid	24.60		0.37	25.70		0.37
	Zinc	2.15	1.03	4.29	2.15	0.88	6.89
LA SARRE	Phenol	1.57			1.62		
	Formaldehyde	12.60			13.05		
	Methanol				50.34		
THURSO	Acetaldehyde	11.84	0.34		11.17	0.33	
	Ammonia	36.53	15.17	0.03	34.34	23.05	1.63
	Chlorine	9.44			13.31		
	Chlorine dioxide	12.71			15.12		
	Dioxin/Furans *(milligrams)*	5.18			14.00		
	Ethylene glycol		0.16			0.21	
	PAHs	0.12			0.12		
	Hydrochloric acid	15.15			14.23		
	Hydrogen sulfide	24.36			23.54		
	Manganese	0.48	11.86	23.90	0.45	11.53	12.34
	Mercury *(kilograms)*	0.29	0.09	2.54	0.28	0.08	1.07
	Methanol	162.06	18.96	0.01	152.66	18.42	0.58
	Sulphuric acid	7.07			7.25		
	Zinc	brt	brt	brt	0.13	3.99	8.01
VAL-D'OR	Phenol	5.80			2.25		
	Formaldehyde	67.10			50.03		
	Methanol	nr			72.40		

nr – Not reported
brt – Below reporting threshold

TOXIC RELEASE INVENTORY (TRI) – UNITED STATES
(in metric tonnes, unless otherwise noted)

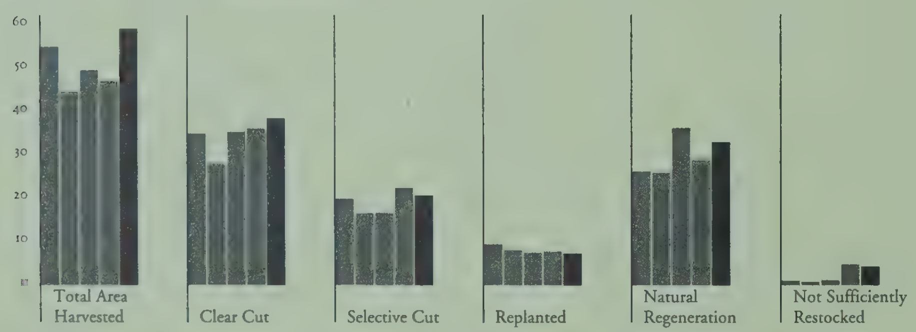
Facility	Material	2000 Air	2000 Water	2000 Soil	2001 Air	2001 Water	2001 Soil
BARTON	Lead compounds *(kilograms)*				0.62		49.51
BEMIDJI	Acetaldehyde	43.40			41.79		
	Acrolein	13.50			23.22		
	Formaldehyde	brt			23.55		
	Lead compounds *(kilograms)*				1.02		
	Methanol	77.00			57.69		
DEPOSIT	Formaldehyde	19.3			18.06		
	Methanol	69.2			76.33		
GUNTOWN	Phenol	0.05			0.05		
	Formaldehyde	0.86			1.31		
	Lead compounds *(kilograms)*				148.78		
JOANNA	Dioxin and dioxin-like compounds *(grams)*				0.15		0.06
	Formaldehyde	4.08			7.71		
	Lead compounds *(kilograms)*				2.04		163.30
	Manganese compounds				0.03		5.90
	Methanol	8.16			14.06		
PARK FALLS	Acetaldehyde	1.17			1.16		
	Ammonia	0.24	1.40	0.13	0.24	1.69	0.24
	Chlorine	0.07			0.01		
	Chloroform	11.18	0.05		0.39	0.01	
	Copper compounds	0.01	0.09		0.01	0.55	0.10
	Dioxin and dioxin-like compounds *(grams)*	0.19	0.77	1.91	0.17		1.15
	Formaldehyde	0.73	1.87	0.04	0.77	0.14	0.06
	Hydrochloric acid	1.02			1.67		
	Lead *(kilograms)*	nr			11.36	10.91	17.73
	Mercury *(kilograms)*	nr			0.45		2.25
	Methanol	4.10	2.77	0.68	4.79	1.48	1.00
	Polyaromatic compounds *(kilograms)*	0.45		12.25	2.72		
MADAWASKA	Mercury *(kilograms)*		0.20	1.60		0.20	1.60

nr – Not reported
brt – Below reporting threshold
Note: newly acquired mills not represented as they were not owned by Nexfor in 2001.

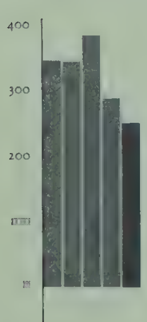
FOREST LAND MANAGEMENT

	Total
Total area managed *(ha)*	2,990,000
Total volume harvested *(m^3)*	4,592,000
Total area harvested *(ha)*	59,000
Area clear cut *(ha)*	38,400
Area selective cut *(ha)*	20,600
Area replanted *(ha)*	7,300
Number of seedlings	11,036,000
Area natural regeneration *(ha)*	32,800
Area not sufficiently restocked *(ha)*	4,300
Area of pesticide treatment *(ha)*	9,800

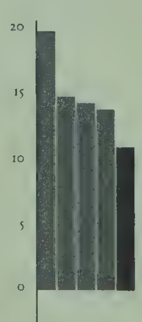
FOREST MANAGEMENT HISTORY
(thousands of hectares) 1998–2002



TOTAL RECYCLED FIBRE USE
(thousands of tonnes) 1998–2002



SEEDLINGS PLANTED
(millions of seedlings) 1998–2002



GLOSSARY

ANNUAL ALLOWABLE CUT
The amount of wood that can be cut without jeopardizing long-term supply. Determining factors include the volume of old growth forest, present age of forest and anticipated yield of each area of new forest at its maturity. In Canada, forest managers calculate annual allowable cut every five years for approval by the provincial Ministry of Forests.

AOX
Adsorbable organic halides. A measurement of a mixture of several hundred chlorinated compounds in the water effluent produced at bleaching plants.

BOD
Biochemical oxygen demand. A method of determining the effect of organic material in effluent on receiving waters, by measuring the consumption of oxygen. Oxygen is required by aquatic life.

CROWN LAND
In Canada, land that is owned by the Government of Canada. Most of the productive forest land in Canada is owned by the government (Crown) and leased to the forest industry for fibre production in return for stumpage or royalty payments.

EBITDA
Earnings before interest, taxes, depreciation and amortization.

EFFLUENT
Residue-bearing water discharged into bodies of water from manufacturing processes.

EMISSIONS
Residue material released into the atmosphere by way of steam or smoke discharged from manufacturing processes.

FBM
Foot-board measure (board foot) equal to one square foot of lumber one inch thick (Mfbm equal to 1,000 board feet).

FOSSIL FUELS
Fuel derived from petroleum or coal such as diesel, gasoline or heating oil.

FREEHOLD LAND
Land that is wholly-owned by the Company.

FSC
The Forest Stewardship Council is an international non-profit organization that supports environmentally appropriate management of the world's forests. It promotes an international labeling scheme for forest products, which provides a guarantee that the product comes from a well-managed forest, and meets internationally recognized criteria of forest stewardship.

GREENHOUSE GASES
A number of gases including carbon dioxide, methane and nitrous oxides, among others, that trap heat in the atmosphere.

GROUNDWOOD PAPER
Paper with mechanical pulp as its major component, which differs from newsprint in brightness, surface characteristics and end uses. Groundwood paper is used in telephone directories and news magazines.

HA
Hectare. A measure of area equal to 2.471 acres.

I-JOIST
An "I"-shaped engineered wood structural member designed for use in residential and light commercial floor and roof construction. The product is prefabricated using sawn lumber flanges and wood structural panel webs, bonded together with exterior grade adhesives.

KRAFT PULP
Wood pulp produced by an alkaline cooking process using sodium sulphate. The pulp is used to produce paper, paperboard and related products.

LWO
Lightweight opaque. Uncoated and film-coated offset freesheet printing paper with basis weights of less than 38 pounds. Examples include bible and dictionary papers.

M^3
Cubic metre. A measure of volume equal to 35.3 cubic feet (264 US gallons).

MARKET PULP
Pulp sold on the open market between non-affiliated companies.

MDF
Medium density fibreboard. A panelboard produced by chemically bonding wood fibres and fibre bundles of uniform size under heat and pressure.

MSF
Measurement for panel products equal to 1,000 square feet.

NSR
Not sufficiently restocked. Harvested areas in which reforestation, whether by planting or natural regeneration, has not been successful, and that will require additional efforts.

OSB
Oriented strand board. A panelboard produced by gluing strands of wood under heat and pressure.

OSHA RECORDABLE RATE
The US Occupational Safety and Health Administration index that tracks the number of recordable work-related health and safety incidents per 200,000 hours worked.

PANELBOARDS
Plywood, oriented strand board, particleboard and medium density fibreboard.

PAPERBOARD
A thick paper used to produce rigid boxes for a variety of packaging uses.

PARTICLEBOARD
A product made by gluing clean sawdust and planer shavings to produce a panel with surface consistency ideal for furniture and industrial applications.

PLYWOOD
A glued wood panel made up of thin layers of solid wood veneers.

ROCE
Return on capital employed calculated as EBITDA divided by the sum of property, plant and equipment, operating working capital (accounts receivable plus inventory less accounts payable) and other assets (excuding a convertible debenture investment).

SFI®
The Sustainable Forestry Initiative® program, managed by the American Forest and Paper Association, is a comprehensive system of principles, objectives and performance measures developed by foresters, conservationists and scientists, that combines the perpetual growing and harvesting of trees with the protection of wildlife, plants, soil and water quality.

SUPER-CALENDERED RELEASE PAPERS (SC RELEASE)
A highly glazed type of paper made especially to be easily removed from and having very little attraction to sticky surfaces (e.g., the silicon-treated sheets that hold self-adhesive labels like name tags, luggage labels and price-tag stickers).

TEXT AND COVER PAPERS
Uncoated fine papers used for brochures, books, catalogues, direct mail, annual reports and stationery.

TONNE
Metric tonne, equal to 1,000 kilograms or 2,204 pounds (1,102 short tons equal 1,000 metric tonnes).

TOXICITY
A measure of the ability of a particular chemical or effluent to cause death or impairment to a test animal or plant. There are many toxicity tests in use for environmental regulation.

TRS
Total reduced sulphur. Odorous sulphur compounds produced in the kraft pulping process that may be emitted into the atmosphere.

TSP
Total suspended particulate. A measure of the solid particles (wood, process dust and smoke) found in air emissions.

TSS
Total suspended solids. Finely dispersed solid material in effluents; low concentrations are desirable.

VOCS
Volatile organic compounds. A large family of carbon-containing compounds. When emitted into the atmosphere, some contribute to ozone layer depletion and some may be toxic in high concentrations. Most contribute, in varying degrees, to the formation of ground level ozone in highly populated areas.

WOODFREE PAPER
Also known as fine paper, made with bleached chemical pulp as its major raw material.

YIELD
A calculation of the efficiency of a production process expressed as a ratio of the product produced divided by the amount of incoming raw material. A yield of 50 percent indicates that one-half of the raw material does not become part of the final product.

CORPORATE GOVERNANCE practices

Nexfor is committed to adopting best practices for corporate governance. Sound corporate governance policies and practices help ensure the interests of our shareholders, employees and the communities in which we operate are continuously maintained.

As a public company listed on The Toronto Stock Exchange (TSX), Nexfor's corporate governance policies and practices, in all material respects, meet the guidelines for improved corporate governance in Canada, adopted by the TSX and suggested by the New York Stock Exchange (NYSE).

ROLE OF BOARD OF DIRECTORS

The Board of Directors is responsible for overseeing the management of Nexfor's affairs directly and through its committees. At all times, the Board acts on behalf of the best interests of the shareholders of Nexfor.

Among its principal responsibilities, the Board:

- Reviews and approves Nexfor's overall business strategy and its annual business plan
- Reviews the risks and alternatives in Nexfor's business to ensure appropriate systems or plans are in place to manage these risks
- Reviews and approves strategic initiatives and capital investment plans to ensure Nexfor's proposed actions are consistent with shareholders' objectives and expectations
- Appoints the Chief Executive Officer and approves the appointment of senior management
- Establishes a compensation plan and approves the compensation of senior management
- Reviews succession and development plans for senior management
- Maintains integrity within Nexfor by reviewing and monitoring disclosure controls and procedures, internal controls and procedures for financial reporting and compliance with the Code of Business Conduct
- Approves Nexfor's financial reports to shareholders
- Sets the Company's dividend policy and approves quarterly dividends
- Ensures the effective operation of the Board and its committees
- Assesses management's performance against approved business plans and key industry performance indicators
- Ensures policies and processes are in place to address key business issues of the Company including financial, environmental, health and safety, business conduct, pension management and communications
- Approves significant and material issues – in addition to those matters that must, by law, be approved by the Board, Nexfor's Board also provides approval on:
  - any disposition or expenditure in excess of $2 million and for any cost overrun on any of these projects in excess of 10% or $1.5 million, whichever is less,
  - any new loan agreement or guarantee for an amount in excess of $10 million,
  - changes in senior management at the Company and its principal operating subsidiaries, and
  - any other material agreement or arrangement that is not in the ordinary course of business.

MEETINGS OF THE BOARD

The Board of Directors meets quarterly, with additional meetings scheduled when required. Three of the quarterly Board meetings are held at the Nexfor corporate office in Toronto. The Company attempts to schedule one quarterly meeting at a Nexfor operation as recommended by the CEO.

COMPOSITION AND SIZE OF THE BOARD

The Board of Directors comprises 10 independent directors, 4 of which are closely related to the Company's major shareholder, Brascan Corporation, and 2 related directors including the CEO. The Board considers that this combination leads to a constructive exchange of views in board deliberations resulting in objective, balanced and informed decision-making.

The Company's directors represent a diverse base of business skills and experiences to ensure effective oversight and reporting.

Independent Board Members
J.W. Bud Bird
The Hon. John G. Bryden
Dian Cohen
Pierre Dupuis
Gordon E. Forward
Margot Northey

Brascan Board Members
Jack L. Cockwell
J. Bruce Flatt
Robert J. Harding
Timothy R. Price

Related Directors
Dominic Gammiero
K. Linn Macdonald (Chairman)

Ten of the twelve directors, comprising a majority of the Board, are unrelated directors within the meaning of the TSX Guidelines. The two directors considered to be related within the meaning of the TSX Guidelines are: Dominic Gammiero, President and Chief Executive Officer of Nexfor since 1999, and K. Linn Macdonald, Chairman of the Board and former President and CEO of the Company from 1991–1999.

It is the policy and practice of the Board that at each regular meeting, the directors meet and discuss the Company's affairs without management directors present. These sessions are conducted under the direction of the Company's lead director, Robert J. Harding, and any material information is reported to management.

COMMITTEES OF THE BOARD

Board committees assist in the effective functioning of the Company's Board of Directors. The composition of the Board committees, all of which consist of independent directors, should ensure that the views of unrelated and independent directors are effectively represented.

Nexfor's Board of Directors has five committees: the Audit Committee, the Corporate Governance Committee, the Human Resources Committee, the Pension Committee and the Environment, Health and Safety Committee.

Special committees may be formed from time to time as required to review particular matters or transactions.

Audit Committee

The Audit Committee is responsible for monitoring Nexfor's systems and procedures for financial reporting, risk management and internal controls, reviewing public disclosure and monitoring the performance of external auditors. The Audit Committee is also responsible for reviewing Nexfor's quarterly and annual financial statements, and management's discussion and analysis prior to their approval by the full Board of Directors and release to the public. The committee also meets regularly in private with Nexfor's auditors to discuss and review specific issues as appropriate.

The committee comprises four unrelated directors: J.W. Bud Bird (Chair), The Hon. John G. Bryden, Pierre Dupuis and Gordon E. Forward.

Corporate Governance Committee

The Corporate Governance Committee meets, in conjunction with the Chairman, to periodically assess the size and composition of the Board and its committees. The Committee reviews the effectiveness of the Board's operations and its relations with management; it assesses the performance of the Board and its directors; it reviews Nexfor's statement of corporate governance practices; it reviews and recommends directors' compensation; and it identifies, evaluates and recommends potential new nominees for the Board of Directors.

The Corporate Governance Committee comprises four unrelated directors: J.W. Bud Bird, Dian Cohen (Chair), Robert J. Harding and Margot Northey.

Human Resources Committee

The Human Resources Committee reviews and reports to the Board on management resource planning, including succession planning and proposed senior officer appointments. The Committee reviews job descriptions and annual objectives and performance of the CEO. It conducts annual reviews of the salaries and other remuneration of the CEO and other officers, including the share purchase and stock option programs.

The Human Resources Committee comprises five unrelated directors: Jack L. Cockwell (Chair), Pierre Dupuis, Gordon E. Forward, Robert J. Harding and Margot Northey.

Pension Committee

The Pension Committee is responsible for overseeing the funding, investment management and administration of Nexfor's employee retirement plans, as managed by the Company's Pension Management Committee (consisting of senior finance and human resources executives). The Pension Committee approves the appointment of Pension Management Committee members; reviews and approves the appointment of outside firms engaged to support the investment and funding activities of the plans; reviews and approves funding objectives, assumptions and strategies in respect of Nexfor's defined benefit plans; and annually assesses the overall performance and regulatory compliance of Nexfor's retirement plans.

The Pension Committee comprises four unrelated directors: J.W. Bud Bird, The Hon. John G. Bryden (Chair), Dian Cohen and Timothy R. Price.

Environment, Health and Safety Committee

The Environment, Health and Safety Committee ensures Nexfor's policies and practices are fully implemented and comply with its operating philosophy of sustainable economic development and the protection and well-being of its employees. The Committee monitors, reviews and reports to the Board on all material matters related to environment, health and safety, and seeks to ensure a timely and satisfactory resolution in accordance with Nexfor's policies and operating philosophy.

The Environment, Health and Safety Committee comprises five unrelated directors: Dian Cohen, J. Bruce Flatt, Gordon E. Forward, Margot Northey and Timothy R. Price (Chair).

NEXFOR MANAGEMENT

The primary responsibility of management is to create value for its shareholders based on an approved business strategy and action plan. If management's performance is found to be inadequate, the Board of Directors is responsible to bring about any management change that will enable Nexfor to perform satisfactorily. Nexfor's corporate governance principles are intended to encourage autonomy and effective decision-making by management while ensuring scrutiny by Nexfor's Board of Directors and its committees.

ROLE OF CHAIRMAN

The Chairman is appointed by the Board of Directors. The role of the Chairman is as follows:

1. Manage the business of the Board and ensure that the functions identified in the Terms of Reference of the Board are being effectively carried out by the Board and its committees
2. Ensure that all Directors receive the information required for the proper performance of their duties
3. Ensure that the appropriate committee structure is in place and recommend appointments to such committees
4. Lead in the annual review of Director and Board performance and make recommendations for changes when appropriate
5. Work with the CEO and senior management to monitor progress on strategic planning, policy implementation and succession planning

ROLE OF PRESIDENT AND CEO

The President and CEO reports to and is accountable to the Board of Directors. The CEO's role is as follows:

1. Provide leadership of the Company and, subject to approved policies and direction by the Board, manage the operation, organization and administration of the Company
2. Present to the Board for approval a long-term vision for the Company together with strategies to achieve that vision, the risks and alternatives to these strategies and specific steps and performance indicators, which will enable the Board to evaluate progress on implementing such strategies
3. Propose to the Board for approval annual capital and operating plans that implement the Company's strategies together with key financial and other performance goals for the Company's activities and report regularly to the Board on the progress against these goals
4. Act as the primary spokesperson for the Company to all its stakeholders
5. Present to the Board for approval annually an assessment of the Company's management resources together with a succession plan that provides for the orderly succession of senior management including the recruitment, training and development required
6. Recommend to the Board the appointment or termination of any officer of the Company other than the Chairman
7. Develop and implement the systems and processes to support the policies established by the Board

BOARD INFORMATION

The information provided by Nexfor management to the Board of Directors is critical to the Board's effectiveness. In addition to reports presented to the Board at regular and special meetings, the Board is also informed on a timely basis by management of corporate developments and key decisions by management in pursuing Nexfor's strategic plan.

New directors are provided with comprehensive information about Nexfor.

All directors have the opportunity to meet and participate in work sessions with management to obtain insight into the operations and business of the Company. Directors are also free to consult with members of management, whenever they so require, and to engage outside advisors with Board authorization.

MANAGEMENT REMUNERATION

Nexfor's remuneration policies are intended to provide a direct link between competitive industry compensation and Company and individual performance. Bonus compensation is reviewed annually by the CEO and approved by the Board of Directors. Periodic reviews of compensation practices are carried out to ensure management is fairly rewarded.

COMMUNICATIONS POLICY

Nexfor keeps shareholders informed of its activities and progress through a comprehensive annual report, quarterly reports and news releases. A regularly updated web site (www.nexfor.com) provides additional information about the Company as well as ready access to published reports, news releases, statutory filings and supplemental information provided to financial analysts and investors.

Directors and management meet with Nexfor shareholders at the annual meeting, held in Toronto, and are available to respond to shareholder questions.

Nexfor's investor relations program seeks to ensure that shareholder enquiries are responded to in a timely manner. Management meets on a regular basis with investment analysts and financial advisors to ensure that accurate information is available to investors, including quarterly conference calls and web casts to discuss Nexfor's results. Nexfor also endeavours to ensure news media is kept apprised of developments as they occur.

All Nexfor communications are carried out in accordance with the Company's Corporate Disclosure Policy, which is posted on Nexfor's web site. This ensures fairness, accuracy and timeliness in reporting material information that is likely to affect the price of Nexfor's publicly traded securities.

OFFICERS of the Company

K. LINN MACDONALD
Chairman
Officer since 1991

DOMINIC GAMMIERO
President &
Chief Executive Officer
Officer since 1993

CHARLES B. GORDON
Vice President,
Corporate Affairs
Officer since 1999

ROBIN LAMPARD
Treasurer
Officer since 2002

LYSE T. MACAULAY
Assistant Secretary
Officer since 1993

BERT MARTIN
Senior Vice President, Nexfor Inc.
President, Fraser Papers
Officer since 1998

YVONNE A. MCKINLAY
Senior Vice President, Nexfor Inc.
President, Norbord Industries
Officer since 1999

GLEN H. MCMILLAN
Vice President, Controller
Officer since 1999

ALAN POTTER
Vice President, Technology and Environment
Officer since 2000

J. BARRIE SHINETON
Senior Vice President, Nexfor Inc.
Managing Director,
Nexfor (UK) Ltd.
Officer since 1999

THOMAS G. STINSON
Secretary and Vice President,
Corporate Planning
Officer since 1988

ROBERT B. STROTHER
Vice President,
Human Resources
Officer since 1988

JOHN C. TREMAYNE
Senior Vice President &
Chief Financial Officer
Officer since 2002

THE BOARD of directors

J.W. BUD BIRD, O.C. (1) (2) (5)
Fredericton, New Brunswick
President, Bird Holdings Ltd.
Director since 1998

THE HON. JOHN G. BRYDEN (1) (5)
Murray Corner, New Brunswick
Senator
Director since 1989

JACK L. COCKWELL (4)
Toronto, Ontario
Co-Chairman,
Brascan Corporation
Director since 1987

DIAN COHEN, C.M. (2) (3) (5)
Toronto, Ontario
President, DC Productions Limited
Director since 1987

PIERRE DUPUIS (1) (4)
Brossard, Quebec
Chief Operating Officer,
Dorel Industries Inc.
Director since 1995

J. BRUCE FLATT (3)
Toronto, Ontario
President and
Chief Executive Officer,
Brascan Corporation
Director since 2002

GORDON E. FORWARD (1) (3) (4)
San Diego, California
Former Vice Chairman,
Texas Industries Inc.
Director since 1995

DOMINIC GAMMIERO
Mississauga, Ontario
President and
Chief Executive Officer,
Nexfor Inc.
Director since 1998

ROBERT J. HARDING, FCA (2) (4)
Toronto, Ontario
Chairman,
Brascan Corporation
Director since 1998

K. LINN MACDONALD
Mississauga, Ontario
Chairman,
Nexfor Inc.
Director since 1991

MARGOT NORTHEY (2) (3) (4)
Kingston, Ontario
Former Dean,
Queen's School of Business
Queen's University
Director since 2000

TIMOTHY R. PRICE (3) (5)
Toronto, Ontario
Chairman,
Brascan Financial Corporation
Director since 1991

COMMITTEES OF THE BOARD
(1) AUDIT
(2) CORPORATE GOVERNANCE
(3) ENVIRONMENT, HEALTH AND SAFETY
(4) HUMAN RESOURCES
(5) PENSION

For full descriptions of the Board committees, please see Nexfor's Management Proxy Circular.

CORPORATE information

Nexfor Inc.

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North American Building Materials

NORBORD INDUSTRIES
(416) 365-0705
www.norbord.com

OSB, Lumber and
Industrial Panels sales:
Toronto, Ontario
(416) 365-0705
1-800-387-1740

European Panels

NEXFOR LTD.
Cowie, Scotland
011-44-1786-812921
www.nexfor.net

OSB and Panelboard sales:

Inverness, Scotland
011-44-1463-792424

South Molton, England
011-44-1769-572991

Benelux, Netherlands
011-31-251-228-080

Paper and Pulp

FRASER PAPERS
Corporate Office:
Stamford, Connecticut
(203) 705-2800
1-877-237-2737
www.fraserpapers.com

Paper sales:
1-800-543-3297

Pulp sales:
(819) 985-5006

Investor Information

2003 FINANCIAL CALENDAR
(dates on or about)

Year-End Earnings Release	January 31
Annual Meeting	April 24
Q1 Earnings Release	April 24
Q2 Earnings Release	August 1
Q3 Earnings Release	October 24
Nexfor Year-End	December 31

ANNUAL MEETING
Thursday, April 24, 2003 at 10:30 a.m.
The Design Exchange, Trading Floor
234 Bay Street
Toronto-Dominion Centre
Toronto, Ontario M5K 1B2

SHAREHOLDER INFORMATION,
TRANSFER AGENT & REGISTRAR, AND
DIVIDEND REINVESTMENT PLAN
CIBC Mellon Trust Company
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inquiries@cibcmellon.com

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info@nexfor.com

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papers produced at our Park Falls mill.
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Text: Synergy, Natural
Synergy, Restful Blue
Synergy, Tan
Synergy, Citrus Green

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